EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENTS ACT OF 1982

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 2226

TO AMEND THE NATIONAL HOUSING ACT TO PROVIDE FOR EMERGENCY INTEREST REDUCTION PAYMENTS AND FOR OTHER PURPOSES

MARCH 23, 1982

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENTS ACT OF 1982

TUESDAY, MARCH 23, 1982

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 9:30 a.m. in room 5302, Dirksen Senate Office Building, Senator Richard A. Lugar (chairman of the subcommittee) presiding.

Present: Senators Lugar, Heinz, Proxmire, Sarbanes, Dixon, and Dodd.

Also present: Senator Slade Gorton.

OPENING STATEMENT OF SENATOR LUGAR

Senator LUGAR. This hearing will come to order.

I would like to make a short opening statement and then I will introduce the distinguished Senator from Washington to introduce the first member of our opening panel.

This hearing of the Senate Housing Subcommittee is called to discuss legislation designed to meet an urgent need to stimulate the American economy. Almost any committee of the Senate could hold such a hearing except for the fact that the legislation before us is designed to produce a significant number of jobs using single family housing construction as the path to that end.

It's also based on the adage that housing led us into the recession and can lead us out. This legislation is under discussion at a time when the national economy shows positive signs for the future. The recession is bottoming out. Will the upturn proceed quickly enough for those who are suffering from perhaps the cruelest aspect of the economy to recover, the unemployed?

My response and that of the 21 cosponsors of S. 2226 is that this is a jobs bill. It's a bill designed to prevent the recession from continuing any longer than is absolutely necessary. It is a bill designed to employ 700,000 people in the next several months, to get them back to work earning income, paying taxes, and contributing in a substantial way to the revitalization and maintenance of the most severely impacted sector of the economy, the home building sector. I'm hoping by beginning the legislative process now we can move rapidly toward enactment and on a track which is separate and distinct from any other important work, including the annual HUD authorizations.

We have a narrow but remarkable opportunity which will not repeat itself. If we cannot enact this bill in the next 90 days we will lose the ability to catalyze the economic forces at work on recovery in a way that will significantly and quickly reduce unemployment.

This bill, as an urgent antirecession measure, does not mean that we are closing our eyes to other continuing responsibilities, such as housing the poor of our Nation. As some of our witnesses will tell us, however, no multifamily housing program designed to act as an economic stimulus has succeeded as such. Only single family housing stimulus programs in the past have had any measurable countercyclical effects. We hope in this bill that we have improved on those programs but, again, timing of implementation is the all important element of our effort.

I think it is important to note that several groups which, historically and regularly, have worked with this subcommittee to design low income housing programs have raised questions as to whether we should separate this bill from the annual HUD legislation or from other more specific efforts to provide additional funding for multifamily programs. I believe the testimony we will receive this morning will show why we cannot make this linkage, but I want the record to show that we hear, we understand, and we are sympathetic to the importance of what these groups are telling us.

This bill does not preclude any other action that our subcommittee may wish to take on HUD programs. In fact, on next Monday, we will have open hearings on these programs as we move in April and May toward reporting the fiscal year 1983 HUD bill. These groups will participate in that process as they have in the past, and to that end I do wish to place in the record a copy of the March 12 letter from 12 organizations representing low income interests. This letter, I believe, does not represent opposition to Senate bill 2226 but, rather, makes a plea that we not lose sight of our other more comprehensive responsibilities, and I want to publicly assure the groups that we will not.

[Copy of S. 2226 and the letter referred to above follow:]

II

97th CONGRESS
2d Session

S. 2226

To amend the National Housing Act to provide for emergency interest reduction payments and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 17 (legislative day, FEBRUARY 22), 1982

Mr. LUGAR (for himself, Mr. D'AMATO, Mr. DANFORTH, Mr. HATFIELD, Mrs. HAWKINS, Mr. HAYAKAWA, Mr. HELMS, Mr. HUDDLESTON, Mr. HEINZ, Mr. KASTEN, Mr. PACKWOOD, Mr. PRESSLER, Mr. WEICKER, Mr. DECONCINI, Mr. GARN, Mr. STAFFORD, Mr. SASSER, Mr. FORD, Mr. GORTON, and Mr. GOLDWATER) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the National Housing Act to provide for emergency interest reduction payments and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title II of the National Housing Act is amended by adding at the end thereof the following:

"EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENTS

"SEC. 247. (a) For the purpose of assisting middle- and lower-income families in acquiring a home, a manufactured home, or membership in a cooperative association operating a housing project, the Secretary is authorized, through the Government National Mortgage Association, to make and to contract to make periodic interest reduction payments on behalf of such families. Such assistance shall be accomplished through payments to mortgagees and lenders or their transferees holding mortgages and loans meeting the requirements of this section.

"(b) The Secretary may not enter into any contract to make emergency home mortgage interest reduction payments under this section during any month unless the Federal Home Loan Bank Board's home mortgage interest rate index for conventional home mortgage loans closed, based on the moving average for the most recent two-month period, exceeds 12.5 per centum per annum.

"(c) To be eligible for emergency interest reduction payments under this section, the first mortgage or loan secured by the property, manufactured home, or shares in a cooperative must be insured under this section or be eligible for insurance under this section, as determined by the Secretary.

"(d) Assistance payments under this section may be made over a period of not to exceed five years with respect to any mortgage.

"(e) The amount of all emergency interest reduction payments made under this section shall constitute a second lien on the property or shares with respect to which the payments are made and shall be repayable—

"(1) when the property is sold;

"(2) when the owner ceases to occupy the property as a principal residence for a period longer than nine months;

"(3) upon any other disposition of the property specified in regulations of the Secretary; or

"(4) upon the refinancing of the first mortgage or loan on the property or shares,

except that the amount repaid may not exceed 60 per centum of the homeowner's net equity, as determined by the Secretary.

"(f) The amount of the emergency mortgage interest reduction payments with respect to any mortgage or loan shall be an amount not exceeding the lesser of—

"(1) the difference between the amount of the monthly payment for principal and interest which the mortgagor or borrower is obligated to pay under the mortgage or loan, and the monthly payment for principal and interest which the mortgagor or borrower would be obligated to pay if the mortgage or loan were to bear interest at the rate of 11 per centum per annum; and

"(2) the difference between the amount of the monthly payment for principal and interest which the mortgagor or borrower is obligated to pay under the mortgage or loan, and the monthly payment for principal and interest which the mortgagor or borrower would be obligated to pay if the mortgage or loan were to bear interest at a rate four percentage points less than the rate specified in the mortgage or loan.

"(g) To be eligible for insurance under this section, a mortgage or loan shall—

"(1) be executed by a mortgagor or borrower whose adjusted gross income did not exceed $30,000 during the year preceding the application for the mortgage or loan and who intends to occupy the property as a principal residence;

"(2) have a principal obligation not to exceed $67,500;

"(3) involve a one- to four-family dwelling the construction or manufacture of which was completed on or after March 6, 1982;

"(4) provide for complete amortization over a period of not to exceed thirty years, but provide that (A) the mortgage or loan payment shall be adjusted for the second, third, fourth, fifth, and sixth years of the mortgage or loan by increasing the payment required during each such year by 0.75 per centum of the original principal obligation, and (B) the amount of the increase will be applied to reduce the principal obligation;

"(5) provide, after the sixth year, for equal monthly payments in the same amount as the amount required in the sixth year, but only for the period necessary to pay off the remaining principal obligation;

"(6) have been accompanied by disclosures of the scheduled adjustments in the monthly payment and of the requirements of subsection (e);

"(7) be originated by a mortgagee or lender who is responsible and able to service the mortgage or loan properly;

"(8) in the case of a manufactured home loan, comply with the regulations issued under section 501(c) of the Depository Institutions Deregulation and Monetary Control Act of 1980; and

"(9) bear interest and contain such other terms and conditions as the Secretary may prescribe.

"(h) The Secretary shall allocate the amount available to carry out this section among the States on the basis of a formula so that—

"(1) one-third of such amount is allocated on the basis of the ratio of the population of each State to the population of all States;

"(2) one-third of such amount is allocated on the basis of the ratio of the decline in one- to four-family housing starts, measured from 1978 to 1981, of each State to the decline for all States; and

"(3) one-third of such amount is allocated on the basis of the ratio of each State's seasonally adjusted unemployment rate for the most recent three-month period prior to the allocation to the seasonally adjusted unemployment rate for all States for such three-month period.

"(i) Any mortgage insured or assisted under this section shall be eligible for purchase by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

"(j)(1) The Secretary shall assure that the amounts allocated pursuant to subsection (h) are made available in a manner which maximizes participation by eligible lenders and borrowers.

"(2) The Secretary shall issue final regulations, make allocations, and issue commitments pursuant to this section not later than thirty days after the enactment of legislation appropriating funds to carry out this section.

"(k) There are authorized to be appropriated to carry out the provisions of this section not to exceed $5,120,000,000. Any sums so appropriated shall remain available for commitment until November 1, 1982.".

○

March 12, 1982

Hon. Richard G. Lugar, Chairman
Subcommittee on Housing and Urban Affairs
1121 Dirksen Senate Office Building
Washington DC 20510

Dear Senator Lugar:

The undersigned groups share a sense of urgency about the present housing situation. We note with interest your introduction of a bill to assist the homebuilding industry and middle income home purchasers in this time of great economic stress.

As you are aware, there are other urgent housing needs today. First and foremost, are the needs of low income people. Indeed, as you have stressed in the past, scarce federal resources should be targeted to the most needy. Accordingly, we urge you to oppose the Administration's proposed rescission of funds for Section 8 and public housing programs that mean housing for low income families. Such rescission would choke off pipeline projects to which commitments have been made and result in thousands of lost homes and lost jobs.

Equally detrimental to our low income families are the Administration's proposed cuts in public housing operating subsidies and modernization funding. In addition, construction of rental housing is as badly needed as single family housing. We therefore urge your support of adequate multifamily production and financing programs, including ending arbitrary restrictions on tax-exempt financing.

While we commend your initiative in introducing home ownership legislation, the undersigned groups cannot support any such measure unless it is part of a comprehensive housing bill directed toward assuring that all Americans have a decent place to live. We hope you agree that aiding middle income homebuyers and the homebuilding industry without aiding the needy would be unconscionable.

Sincerely,

Council for Rural Housing and Development
1800 M Street, N.W., Washington, D.C. 20036

Interreligious Coalition for Housing
1821 Redwood Terrace, N.W., Washington, D.C. 20012

National Association of Counties
440 First Street, N.W., Washington, D.C. 20001

National Association of Housing and Redevelopment Officials
2600 Virginia Avenue, N.W., Washington, D.C. 20037

National Housing Conference
1126 16th Street, N.W., Washington, D.C. 20036

National Housing Law Project
1016 16th Street, N.W., Washington, D.C. 20036

National League of Cities
1301 Pennsylvania Avenue, N.W., Washington, D.C. 20004

National Leased Housing Association
1800 M Street, N.W., Washington, D.C. 20036

National Low Income Housing Coalition
215 Eighth Street, N.E., Washington, D.C. 20002

National Urban Coalition
1201 Connecticut Avenue, N.W., Washington, D.C. 20036

National Urban League
425 13th Street, N.W., Washington, D.C. 20004

U.S. Conference of Mayors
1620 I Street, N.W., Washington, D.C. 20006

Senator **Lugar**. Now I would like to call upon my distinguished colleagues on this Committee, first of all, Senator Proxmire, for any opening statement or comments that he might have.

Senator **Proxmire**. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR PROXMIRE

Mr. Chairman, first, I congratulate you on introducing the bill. I'm not cosponsoring the bill as yet. I'm very interested in the bill. It has some extremely interesting elements. One, of course, is the payback which I think makes a lot of sense. In other words, the Federal Government in the long run would not be out the full cost of subsidy because, of course, when the homes are sold, as I understand it, the cost of the subsidy would be paid back, and I think that does have a lot of merit.

Also, of course, it acts to provide a clear and conspicuous stimulus to homebuilding at a time when we need more homes urgently. We are down to a level below 1 million housing starts a year, have been for months, and that means that we don't have the houses we have to have.

Then, in addition to that, of course, we have a great need for jobs. There's no industry that has suffered a more precipitous decline in jobs. I calculate that we've lost 1 million housing starts last year. Every housing start is 2 man years of work. That's 2 million jobs. That's a very large proportion of all the increase in unemployment.

In addition to that, we have a great need for the survival of homebuilders. This is a fine industry with very hard-working people who in my state and all the States, have built up a reputation over the years for competence and diligence, and even the best firms that have been in families for years and deserve to be preserved can't make it.

But the big question I have, the reason that I haven't made a commitment on this bill yet, is will it work? Will it really work? As I calculate this bill, what it will do is cost the Federal Government relatively little in budget costs, but it will increase the demand for credit by $26 billion. If that is accommodated by the Federal Reserve, then it may be the additional net jobs here, the 791,000 jobs that are estimated. If, on the other hand, the Federal Reserve makes no adjustment, where is the credit to come from? Much of it would come from other housing that would have been built absent this. It would come in the process of bidding up the cost of mortgages for those who aren't in on this operation even above the terribly high level it is now.

Some of the rest of it will come out of the automobile industry and other industries that aren't being subsidized, unless there's an accommodation by the Federal Reserve.

For that reason, it seems to me that aspect is very critical and we should be very sensitive to what this will do in the credit markets generally because otherwise there's no magic wand you can wave and provide 791,000 jobs net unless, as I say, you get an adjustment that recognizes the fact that we are operating far below capacity in the homebuilding industry as well as in other industries, and perhaps there should be an accommodation by the Federal Reserve. But that's something that this Committee is peculiarly qualified to work on because we are the Banking Committee and we have jurisdiction over the Federal Reserve operations.

Senator LUGAR. Thank you very much, Senator Proxmire.

Senator Alan Dixon of Illinois, do you have a comment or opening statement?

Senator DIXON. I thank the Chair. I have no statement at this time.

Senator LUGAR. Thank you very much.

I would like to introduce the first panel made up of Mr. William Ruckelshaus, senior vice president of Weyerhaeuser Corp. of Takoma, Wash.; Frederick Napolitano, president of the National Association of Homebuilders; and Robert Teeter, president of Market Opinion Research who will join us in a few minutes.

I'd like to call upon the distinguished Senator from the State of Washington, Senator Slade Gorton, to introduce Mr. Ruckelshaus.

STATEMENT OF SENATOR SLADE GORTON, U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator GORTON. Thank you.

Mr. Chairman, Senator Proxmire and Senator Dixon, I am here this morning for two reasons. The first is to reaffirm my support of your S. 2226, of which I'm an original cosponsor. I am convinced it's a necessary measure to provide short-term targeted relief for the Nation's depressed housing industry and to my own State's equally depressed forest products industry.

Depression is not a word which I would use lightly, but it aptly describes current conditions in much of Washington State. I'm very much afraid that without immediate relief we may do irreparable damage to the region's forest products industry as well as to our human resources if the effects of record high unemployment rates continue to take their toll.

For this reason I am enthusiastically in support of your legislation.

My second reason for appearing before you this morning is to introduce my good friend and yours, William Ruckelshaus. Mr. Ruckelshaus will offer testimony on the bill. As you know, Mr. Chairman, Bill Ruckelshaus is a proud native of the Hoosier State. He served the people of Indiana during a distinguished career which included service as Deputy Attorney General, member of the Indiana House of Representatives, the majority leader of that body.

In 1970, Bill was called to Washington, D.C. where he continued his career of public service as Assistant Attorney General of the U.S. Department of Justice, Civil Division. He subsequently served as Administrator of the Environmental Protection Agency and later as Acting Director of the Federal Bureau of Investigation.

In 1973, he became Deputy Attorney General of the United States. Bill capped his Washington, D.C. tenure by becoming senior partner of the law firm of Ruckelshaus, Beverage, Fairbanks, and Diamond.

Bill joined the Weyerhaeuser Co. in 1976 as a member of its senior management committee. It is in that capacity that he returns to the Capitol today. I know that I speak for my colleagues here in the Senate when I say that I'm honored to have the benefit of his expertise, experience and finely-honed judgment once again.

The people of Washington State could have no finer advocate before your Committee than Bill Ruckelshaus.

Senator LUGAR. Thank you very much for coming this morning, Senator Gorton. Mr. Ruckelshaus, will you now proceed with your testimony?

STATEMENT OF WILLIAM RUCKELSHAUS, SENIOR VICE PRESIDENT, WEYERHAEUSER CORP., TAKOMA, WASH.

Mr. RUCKELSHAUS. Mr. Chairman and Members of the Committee, I have submitted a written statement and I would prefer, with your permission, to summarize that statement in the interest of time.

Let me start out, Mr. Chairman, by commending you for introducing this bill and for addressing an urgent and pressing national problem, namely, how do we get this recovery going; how do we put our people back to work?

The statement itself goes into some detail regarding the situation in the forest products industry. In short, that situation is the worst in the last 40 years. We are currently running as an industry at about 50 percent of capacity utilization. Hundreds of mills across the country are closed or curtailed. Tens of thousands of people are either out of work or employed part time. Unemployment in the industry is close to 20 percent today and that includes only those who are receiving unemployment compensation. We think, in fact, it's something greater than that. It's more than twice the national average.

We see no immediate end in sight. I could go on, but I think the point is made, Mr. Chairman.

The real purpose of this hearing is not to bail out the forest products industry or even the housing industry, no matter how beleaguered those industries might be.

The purpose of the legislation and for which I commend your action is to spark an economic recovery, to get it started. In fact, Mr. Chairman and members of this committee, if my only plea today was to help my industry, I think you should listen in sympathy and tell me to get in line. Certainly our industry is not the only one today in this country that is in difficulty, even though, given the effects of monetary policy we have been cyclically disproportionately affected by the rise and fall of interest rates.

LEGISLATION IS A RECOVERY STIMULUS

Even so, if this is all that I was here to discuss, if this was all this bill was to address, I think that our plea should not be answered by this committee. In fact, your legislation is a reemployment measure. It's a recovery stimulus and should be so viewed. It's an effort to begin to realize the promise of the efforts of the administration and the Congress last year. The housing industry, in our view, is uniquely situated to get the recovery started in that it is so susceptible to the rise and fall of interest rates. No other industry is, in fact, in the same position.

It is no accident that housing has led this Nation out of every recession since World War II. It leads us in and it leads us out. Historically, when the economy slackened, interest rates declined, and as the bottom was reached, housing, the most credit sensitive of all industries, started back up.

In place then, in place historically, and in place now, were land, manpower, materials, and markets—markets in the form of people ready and able to buy at affordable interest rates, interest rates which both economically and psychologically people were qualified to pay.

The same conditions apply today. The missing element is interest rates at a level that will unleash the willing buyer.

Your bill, Mr. Chairman, directly attacks that missing element—interest rates. In fact, your bill has all the elements necessary to get the recovery going in harmony with the Congress and the administration's program enacted last year.

First, most importantly, it lowers interest rates to home buyers. It provides assistance to the purchaser of a home and all the evidence we have points to this as the trigger to get housing back on track. The economic evidence of where interest rates need to go in order to stimulate purchases, empirical evidence, on the part of my own company, Weyerhaeuser, where we find that by buying interest rates down in an effort to move inventory, even if it's necessary to move it at a loss, we attract a number of buyers into the market. The surveys that have been taken and provided to this committee by Market Opinion Research also indicate that as interest rates move down toward 12 percent, a number of home buyers come into the market who are otherwise walled off because of the higher rates.

Second, the bill would provide a massive stimulus to the economy, something in the neighborhood of 600,000 to 800,000 jobs at a relatively low cost to the Treasury, some $1 billion a year for 5 years. The benefits to the country are significant in terms of reemployment if we assume that the bill achieves its purpose of reemploying people now out of work in the homebuilding and related industries. If we assume the reemployment of 1 percent of our work force under the Government's statistics it would provide something like $25 to $30 billion to reduce the deficit.

The bill, as Senator Proxmire mentioned, also contains a recapture provision. All of the subsidy would be recaptured when the home is either sold or refinanced or at least up to 60 percent of the net equity of the home. The program is short term. It is aimed specifically at getting this recovery moving. It ends the end of October and it's structured to phase out as the recovery quickens so we don't have a continued subsidy of home buyers once the recovery gets moving and interest rates start to come down.

The bill buys down interest rates only to 11 percent and terminates when those rates hit 12.5 percent for 2 straight months.

Lastly, it is aimed at the walled-off markets, the low- and middle-income home buyers, and this is done by setting a mortgage limit of $67,500 and an income level of some $30,000.

Mr. Chairman, in my opinion and in the opinion of the vast majority of my industry, you have adopted the right program with the right set of principles to fit our Nation's immediate and urgent needs. This bill or one very much like it—and the reason I say one very much like it is I think that all of these assumptions should be tested as carefully as possible to insure that we achieve the goal that as Senator Proxmire has suggested, it works, and that it does what all of us want it to do.

In the event those assumptions prove out, and I think they will, it should be acted on immediately by this Congress so that the machinery of government can be put in place to put people back to work this summer. Not to act I think is to risk unnecessarily delaying or even conceivably aborting the recovery. This country wants to go back to work and with a little push from Congress I think it can.

Thank you, Mr. Chairman.

[Complete statement follows:]

STATEMENT OF WILLIAM D. RUCKELSHAUS

Mr. Chairman, members of the Committee, I am William D. Ruckelshaus, senior vice president of the Weyerhaeuser Company in Tacoma, Washington.

I appreciate this opportunity to express my views on S. 2226. Of all the measures under consideration to spur employment and get the economy moving, I believe this bill is the most cost-effective. It is designed to be an emergency, temporary measure only and would recapture a substantial portion of the Federal funding required to get it started. The purpose of S. 2226 is straightforward: to provide mortgage financing in the 12 percent range, the level we believe necessary to get the home buyer back into the market.

The key reason to urge consideration of this bill—in addition to the cost-effectiveness—is that it would not derail the excellent beginning made last year by the Administration and Congress in redirecting national priorities. The forest products industry has been, and remains, in full support of that program.

I believe that S. 2226 is compatible with the President's program and will provide the needed stimulus to help the country move from recession to an investment recovery.

I think most of you know about the economic devastation afflicting the forest products industry. This has been the case now for more than a year, and has worsened over the winter months. It is unequalled in the last 40 years. All across the country the lumber and plywood industry is operating at little more than half normal levels. This means hundreds of mills are closed or their operations are curtailed, and tens of thousands of people are out of work or on short hours. Unemployment in the industry in February reached 19.1 percent.

In 1981, lumber production fell to less than 30 billion board feet, it's lowest level since World War II, and 1982 is headed sharply lower. Shipments of softwood lumber in January were off 37.2 percent from January 1981. Approximately 40 to 50 percent of the softwood lumber and plywood consumed annually in the United States is used in domestic building.

With the collapse of the housing market, prices for wood products have fallen sharply. Producers of lumber and plywood have been selling at a loss for many months. Since wood products are commodities, their prices reflect changing conditions of supply and demand. Mills that are still running simply cannot continue to operate indefinately in the red.

Already in Washington State, where I live, there are communities where half of the workforce is unemployed. State unemployment is over 12 percent in spite of the fact we thought considerable progress has been made in diversifying our economic base over the past 20 years.

When the effects of huge federal deficits are piled on a state already suffering these kinds of problems, the effect can be close to catastrophic. That is another reason I'm here today—because I believe that if S. 2226 is enacted, it will be effective in relieving the financial crisis being faced by many state and local governments in terms of unemployment and revenue shortfalls.

The importance of the housing industry in solving our current economic problems in this country cannot be overestimated. Historically, there has not been a recovery since World War II where housing has not led the way. This was true in 1958, 1962, 1967, 1971, and 1976, and even in the short-lived upturn of 1980-81. The current recession is no exception to that rule.

There are basic structural reasons for the importance of housing in a recovery. With capacity utilization in the general economy at a low rate, currently 72 percent, increased investments are not needed. These investments cannot be made when cash flows are weak, the costs of borrowed capital are high, and the outlook for a recovery is uncertain. Even the cash contribution of the business tax cut of 1981 has been dwarfed by these negatives of the recession. Under these circumstances, increased capital investment must follow the lead of other sectors in the economy. One of those key sectors is housing.

Past recoveries have always been led by home building for one simple reason: housing is the most credit-sensitive sector in the economy. But housing demand can be translated into actual starts only if interest rates for home mortgages are affordable. With mortgage interest rates high, demand for housing is postponed. That's the "Catch 22" of housing. Unlike other industries where demand slackens during a downturn, housing demand only accumulates, building higher and higher, waiting for affordable sources of mortgage fund.

In the current recession, action is needed to stimulate housing and assist the sector experiencing the worst brunt of the downturn—construction, building material suppliers, furniture and home appliances—areas where businesses that have survived all of the cycles of the last 40 to 70 years are currently facing bankruptcies and shutdowns.

The capacity of these businesses to support a housing recovery is eroding rapidly. But if they can be helped before it's too late, the income they generate will begin to flow into a broader set of products and, at the same time, reduce government transfer outlays. The broadened economic recovery would increase other business cash sources and provide the basis for the much needed investment recovery.

A housing recovery is a vital factor in lowering unemployment, particularly in the early stages when most other industries are still in decline. The building industry alone can account for 20 percent of the employment gain in the early stages and when supplier employment is added on, the contribution can approach 80 percent. In fact, on several occasions, housing has contributed over 100 percent of the gain in the early going.

An increase of 500,000 housing starts, for example, would create an additional 800,000 jobs for a one percent reduction in the Nation's unemployment rate. Using government estimates of the sensitivity of the deficit to unemployment, this should reduce the deficit by some $30 billion.

In all previous recessions, the release of this latent housing demand was triggered by the availability of affordable mortgage credit at the bottom of the recession. But, today, with deregulation of banking, it's no longer possible for thrift institutions to lend long when they have no control over the cost of short-term money. Flexible rate mortgage instruments can be developed and marketed over time, but not quickly enough for many builders and suppliers to survive the wait.

This, then, will be the first recession where declining short rates alone will not trigger an automatic housing recovery. As the economy weakens and short-term rates decline with the retrenchment of business investments, there will be no rapid increase in credit uses. There may be long-term refinancing to liquify corporations, but little new investment. Without a housing-led recovery the general economy will, at best, stagnate with unemployment and bigger deficits.

What is needed is a short-term emergency program like S. 2226 to speed the transition to a higher investment economy—a program which will appeal to the lower and middle-income consumer ready and able to buy a new home except for the specter of high interest rates. Such a program would also buy time for the development of more competitive mortgage instruments.

Most important, because the costs of such a program are more than offset by increased tax revenue and reduced unemployment payments, the program would essentially be self-supporting over time.

The consequences of taking no action on housing are serious, both in terms of an inadequate recovery ballooning deficits further and the danger of setting off more inflation in housing as the postponed demand becomes even larger. If housing had recovered earlier, as many forecasters expected last year, the deficit would not be as unmanageable as it now appears today and business investments would not have been so seriously depressed.

We should not forget the lessons of the 1974 and 1975 recession. Not only did business investments collapse, producing a reduction in credit demands, but the extended downturn in housing starts produced an accumulated backlog in housing demand that forced up house prices to record highs when interest rates did decline. Demand then far outstripped the industry's ability to build houses, setting up an inflation spiral in home prices.

The causes of the rapid rise in home prices in the last few years should not be ignored. Action is needed now to allow an increase in starts to work off the accumulated demand backlog. If there is no action, the problem will become even greater as interest rates eventually work their way down to affordable levels and trigger another damaging round of housing inflation.

Before I conclude, let me emphasize my concern about the projected budget deficits for the next several years. Federal government borrowing in the credit market must be reduced substantially. I urge Congress to work closely with the Administration in getting these deficits under control. Only by coordinated fiscal and monetary policy can we whip the dual problems of inflation and high interest rates. Both problems are causing untold grief for both business and consumers.

Let me also emphasize that the housing industry and its suppliers represent a huge construction and supply complex that is ready and able to produce housing for Americans. This complex is now unused and atrophying. Housing is uniquely qualified to lead the nation's recovery. Public opinion polls indicate there is a vigorous demand for moderately priced houses when long-term mortgage interest rates approach 12 percent. S. 2226 would provide the stimulus needed to get housing moving and to help pull the economy out of recession.

Thank you Mr. Chairman.

Senator LUGAR. Thank you very much, Mr. Ruckelshaus.

At this point the Chair would like to recognize that we've been joined by additional colleagues, Senator Dodd of Connecticut and Senator Heinz of Pennsylvania. Senator Dodd, do you have an opening comment or statement that you would like to make?

OPENING STATEMENT OF SENATOR DODD

Senator DODD. I do, Mr. Chairman, and I'll be very, very brief, and I apologize for not being here exactly at 9:30 and commend you on your punctuality in getting these hearings moving. I know how difficult it is to stay on schedule.

Begging the indulgence of our distinguished witnesses, and I'll be very brief with this, Mr. Chairman, I'm delighted that you're having these hearings and I share your concern with the urgent need to address the virtual depression conditions facing the American homebuilding industry.

I cannot agree, however, with the implications of today's hearing that this is the only issue, as the chairman has pointed out, in the housing area which merits our immediate attention and action. In fact, this Nation is experiencing housing problems of varied and crisis dimensions. This is evident not only in the lowest annualized level of housing starts since 1946 and the highest level of business failures, but it's also reflected in the plight of lower income families, senior citizens, and moderate income working families in search of decent, affordable ownership in rental housing oportunities.

The Nation's housing needs are increasing at a time when economic policies and budget recommendations actually will exacerbate the situation. I believe that we have an obligation to reverse this pathetic record and respond in a targeted manner based on a more realistic recognition of this growing problem.

If I may, Mr. Chairman, let me just mention some of the deplorable conditions which will not, unfortunately, be addressed by this specific piece of legislation.

There are some 1.4 million rental households with annual incomes below the poverty level, and they will pay a median rent which represents 72 percent of their income for shelter and will leave them roughly $71 a month for all other household needs. The national rent vacancy rate remains at a historically low level of 5 percent, and it's significantly lower in specific market areas in various geographic areas around the country. A recent report estimates a shortfall of approximately 3.75 million rental units during the 1980s. In May of 1981, a survey of 22 public housing agencies confirmed that over 300,000 households are on their waiting lists, or roughly 83 percent of the total occupancy.

In Hartford, Conn., the average wait for public housing is 2½ years. In New York City, it's 11.3 years. In Baltimore, it's 14 years. In Chicago, it's almost 2½ years. We have some 5.3 million lower income households that continue to live in physically inadequate housing for renters; 13.3 percent of the units are inadequate. And for all black households in America, it's almost 20 percent.

In 1981 the savings and loan associations lost $6.4 billion, more than the auto, the airline, and the timber industries combined. It's estimated that if the interest rates do not recede some 900 S&L's will exhaust their net worth in the next 24 months.

As I stated, Mr. Chairman, I agree there's a pressing public purpose to stimulate this industry which is so vital to the prospects of our overall economic recovery, and for this reason I intend to support the concept of the legislation you have offered, although I do have several concerns with specific proposals as well as reservations with regard to the overall size of the program.

In good conscience, we cannot respond to only one aspect of the most serious housing problems facing the American people in the past 40 years. I believe that we can move just as quickly to put together a fiscally responsible, comprehensive program which deals with both immediate and long-term concerns. For this reason, I oppose separate action on this measure until we have come to some agreement that these other matters will be addressed in a significant way. For if we fail to act in such a balanced fashion, the divisions which we will create among income groups and competing legitimate demands for some governmental attention will far outweigh the benefits of any short-term possible economic stimulus.

I'm making this point, Mr. Chairman, while again stating my general endorsement of the legislation which is the subject of today's hearings. This legislation, in combination with the administration's budget legislation for housing does not represent a substantively or a politically supportable national housing policy. But, more directly, the need to stimulate construction of 450,000 single family homes loses some legitimacy if we at the same time condone the continuing deterioration of 1.3 million existing units of publicly owned housing for low income families and senior citizens.

Since we're concerned about jobs, why don't we also consider a significant expansion of existing programs to rehabilitate and retrofit the existing inventory of federally assisted insured housing which would get an immediate employment stimulus, improve energy conservation and protect the public investment?

Since we are in agreement that housing production produces jobs, why don't we assume that a commitment to support rental and low income housing does not result in immediate economic benefits as well?

For those who feel this broader task is not possible because of potential time delays and budget pressures, I would simply answer that the political process responds to a crisis in an expeditious manner only when there is broad consensus.

With respect to the budget issue, I believe that these activities, which received the single largest reduction of any program in last year's budget—almost $1 out of every $5 we cut last year in the budget came out of the housing area—and I believe at least that we ought to at least hold the line this year so that other areas can assume some responsibility, not just housing.

In conclusion, the responsibility to act in response to the situation as it exists is ours. Unfortunately, the administration to date has not offered a housing policy but, rather, more budget cuts of a magnitude of last year in this area. It's a budget of recaptures and rescissions. They would have us cancel more pending housing than would be built and aggravate the desperate plight of lower and moderate income citizens by perpetuating a constrained supply of housing, and forcing the poor to contribute unconscionable portions of their income for shelter.

Mr. Chairman, you have taken an important step here by offering this program and necessary resources above the administration's budget. I think we have to follow and expand on your lead. We must do this in a bipartisan fashion which does not force unsupportable choices between income groups, industry representatives or geographic areas. And toward this broader objective, Mr. Chairman, you have my undying support, but I do believe we ought to consider a broader program.

I thank you for allowing me to break into the testimony of our witnesses for that statement.

Senator **Lugar**. Thank you very much, Senator Dodd.

Senator Heinz, do you have an opening statement?

OPENING STATEMENT OF SENATOR HEINZ

Senator **Heinz**. I would like to make these comments. First, I want to commend you on having held these hearings. I'm a cosponsor of your bill. I think it's an excellent bill. I hope it moves ahead. I think it should move ahead because the state of our housing and construction industry is extraordinarily serious.

We have a sick economy. We know that. The economists have coined a word to describe it in the last few weeks. They have called it a repressed economy. Recession wasn't good enough. Depression was too strong. We are repressed.

But the fact is that the housing and construction industry is by any measure going through a depression. I don't have the most recent statistics. I have the November statistics where 18.2-percent unemployment was being suffered in the construction industry. That meant there were 900,000 employees out of work. There were also another 200,000 self-employed people out of work. That is 1,100,000 out of our roughly 9-plus million people out of work accounted for by just one industry.

What that means to the Federal deficit is roughly $35 billion a year in additional deficit.

So what Senator Lugar's bill, it seems to me, is addressing is nothing less than a real depression in an industry. Now we all know that the only long-term solution is getting the interest rates down and until we get the Federal deficits down—the ones for 1983 and 1984 and 1985 as projected—they are currently projected at much too high a level—we know there won't be a permanent solution. But we also know one other thing, that no matter how hard we try—and I trust we will succeed—in getting deficits and interest rates therefore down, if we are to make any progress on ending this recession. It is a fact that every single recession has been ended by a recovery in homebuilding. No recession has ever really ended until the homebuilding industry itself has led the Nation out of such a recession.

In fact, one of the compelling reasons for Senator Lugar's bill is that we judged by all the economic experience we have had over the last 40 years we'll be unsuccessful in ending this recession unless the housing industry helps us do it; and the purpose of Senator Lugar's bill, of course, is to achieve that goal.

One other comment I would like to make, Mr. Chairman, and that is with respect to the more explicit purpose of your bill.

Your bill is not a bailout of an industry. Some people may characterize it that way, but it doesn't give money to a corporation. It doesn't give money to Chrysler. It doesn't provide a financial transfusion to a set of businesses, such as savings and loans which of course are very depressed right now. What it does is it gives an interest break, not to a homebuilder, but to a home purchaser up to 500,000 home purchasers, individual people; and I'd suggest there's an important and compelling reason for approaching it that way.

First, we don't directly, I would argue, help an industry. We help people. And second, we further something that is extraordinarily important to the character of this country; namely, homeownership.

There's a lot to be said for making sure that the poor and moderate income people have adequate shelter, but in my view, the basic character of this country has been influenced by the fact that the vast majority of Americans, over 80 percent, owned their own homes. They have a stake, literally and figuratively, in this country. Homeownership is one of the great conservative forces in this country. I say conservative not in the political sense. I use the term conservative in the sense of preserving that which is best.

If this country were ever to be transformed from a nation of homeowners into a nation of renters, I think you would see a concomitant loss of people's feeling of control over their own lives and that would be a very heavy loss indeed, with all kinds of economic and political consequences I would hate and I think most people would hate to see.

For that reason, I think Senator Lugar's bill, aimed as it is at homeownership, aimed as it is at individual purchasers, aimed as it is to their desire to acquire housing, at bringing this Nation out of our current recession, is indeed a very worthwhile and important effort on its own.

Mr. Chairman, thank you.

Senator **Lugar**. Thank you very much, Senator Heinz.

The Chair would like to call upon Mr. Napolitano, president of the National Association of Homebuilders, for his testimony. Welcome.

STATEMENT OF FREDERICK J. NAPOLITANO, PRESIDENT, NATIONAL ASSOCIATION OF HOMEBUILDERS, ACCOMPANIED BY ROBERT D BANNISTER, SENIOR STAFF VICE PRESIDENT FOR GOVERNMENT AFFAIRS; AND JIM SCHUYLER, STAFF VICE PRESIDENT AND LEGISLATIVE COUNSEL

Mr. NAPOLITANO. Mr. Chairman and members of the subcommittee, my name is Fred Napolitano and I'm a homebuilder from Virginia Beach, Va. I'm testifying here today on behalf of the more than 114,000 members of the National Association of Homebuilders known as NAHB.

Mr. Chairman, since November of 1981 NAHB has suffered a loss of over 9,000 members, most of them through bankruptcies. NAHB is a trade association of the Nation's homebuilding industry, of which I am president. Accompanying me today are Bob Bannister and Jim Schuyler.

I would like to submit my full statement for the record and I'll try to summarize what I have here.

Senator LUGAR. Without objection, it will be made into the record.

Mr. NAPOLITANO. I would also like to point out to the chairman and the committee that there's one area in my statement where I refer to multifamily. By multifamily, we mean condominiums and cooperatives and not multifamily in the sense of rental units. That will be changed and it's a name that I believe is used by the Government, but in the industry multifamily and single family are two different areas.

Senator LUGAR. That appears on attachment A in the chart?

Mr. NAPOLITANO. That's right, sir.

[Complete statement follows.]

STATEMENT OF THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. Chairman and members of the subcommittee, my name is Fred Napolitano and I am a homebuilder from Virginia Beach, Va. I am testifying today on behalf of the more than 114,000 members of the National Association of Homebuilders (NAHB). Mr. Chairman, since November of 1981 NAHB has suffered a loss of over 9,000 members. NAHB is a trade association of the Nation's homebuilding industry, of which I am President. Accompanying me today are Robert D. Bannister, senior staff vice president for Government Affairs and Jim Schuyler, staff vice president and legislative counsel.

Mr. Chairman, I am deeply grateful to appear before your subcommittee this morning. This hearing reflects your sense of urgency and the leadership you have shown in introducing this vitally important bill and seeking its rapid enactment. I speak for our entire beleaguered industry which offers you our thanks, encouragement and prayers for the succes of your efforts. We are especially pleased that the distinguished chairmen of this committee, Senator Garn, Senator Heinz, and Senator D'Amato have given you their support.

As you know, Mr. Chairman, we have appeared before this subcommittee for the last 3 years and have warned that all signals pointed to a housing depression that would have grave consequences for the national economy and the social and political fabric of our Nation unless positive action were taken to avoid such a catastrophe. I do not believe that we underestimated or overdramatized the gravity of the crisis. My message today is simple and clear—the housing collapse that we feared but prayed would not occur is upon us. And its impact on the national economy in terms of lost jobs and lost federal revenues has already been significant.

I need not repeat the statistics which are graphically outlined in my testimony.

HOUSING PRODUCTION

New housing production in 1981 totaled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980's. Last year was the worst housing production year since 1946.

1982 could finish as the worst postwar production year yet. NAHB's optimistic forcast for this year holds annual production to about one million. Housing starts in February fell to a seasonally adjusted annual rate of 953,000, down 26 percent from a year earlier, and down more than 52 percent from the 2 million annual production levels in 1977 and 1978. February was the seventh consecutive month that housing starts were below the one million annual level.

February is the 38th month of recession in housing. The previous record was set during the Eisenhower Administration when the housing recession lasted 27 months.

NEW HOME SALES

1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 436,000 new homes were sold, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.

Since March 1981, annual new homes sales rates have been under the 500,000 level. In January of this year, the annual sales rate of new homes was 353,000.

Actual sales in January nationwide were 25,000 new homes—roughly the monthly number of new homes that were sold in the West alone during 1978 and 1979. In all of the Western states, only 7,000 new homes were actualy sold in January. Only 4,000 new homes were sold in the Northeastern and North Central states combined.

INTEREST RATES

Conventional mortgage interest rates now average 17 percent. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.

Interest rates normally fall rapidly and decisively during recession, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15 percent this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depression levels until mortgage rates drop to the 12 percent range, which by historical standards still represents an extrordinarily high cost of home financing.

By reducing interest rates from 16 percent to 12 percent, 4.6 million additional families could qualify for a $65,000 mortgage. At 12 percent interest rates, more than 22 percent of the nation's families have the $35,000 income needed to qualify for a modest $65,000 mortgage. At 16 percent rates, fewer than 14 percent have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

Unemployment in the construction trades in February was 18.1 percent or 928,000 unemployed workers, accounting for 10 percent of the total unemployed work force. Another 200,000 skilled craftsmen could lose their jobs over the next several months.

An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.

Bankruptcies are up 51 percent for construction firms and 65 percent for subcontractors.

Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1 percent increase in unemployment costs the Treasury $25 billion—$19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

UNITED STATES VERSUS THE WORLD

New housing production in the United States is outdistanced by almost every industrialized nation and the Soviet Union. Among the major Western nations only Great Britian has recently been investing less in its housing stock than the U.S.

In 1946, 8 housing units were produced per thousand of U.S. population. Last year, the U.S. rate fell to only 4.2 starts per thousand. In the U.S.S.R last year, housing production was reported at 8 units per thousand.

1981 housing production in Japan was higher than in the U.S., even though it has roughly one-half the population. And they thought they were in the midst of a downturn.

Private residential investment in 1980 was only 4 percent of our nation's Gross National Product, compared to 6.8 percent in France and West Germany, 6.5 percent in Japan, 5 percent in Italy and 4.8 percent in Canada.

According to the Federal Reserve Board, housing's share of the credit markets has declined from 31 percent in the 1950s and about 25 percent in the 1960s and 1970s to only 16.4 percent in 1980–81. By comparison, the federal government's share has increased from 7.7 percent in the 1950s to almost one-third last year.

Mr. Chairman, it is with this pessimistic but realistic perspective that we view the need for emergency housing legislation in fiscal year 1982 and fiscal year 1983. As you have recognized in your bill, we are a unique industry. We have the land, labor, materials and market that can help turn this economy around in a short period of time. We are the one industry that can break the logjam of bad economic news and put America back to work. Your plan, Mr. Chairman, could begin to put 500,000 to 650,000 people back into the workforce by this summer if this legislation moves on a "fast track." (See charts on economic impact of program attached as Exhibit "A".)

Let me say that we have reviewed a variety of alternatives and have applied the three tests which the Chairman has referred to: (1) rapid job creation; (2) consistent with the long-term economic recovery program; and (3) temporary in nature. We have reached the conclusion that only an interest reduction program would have the desired impact. Mortgage interest rates must be reduced to the 11 percent to 12 percent range to make modest-priced housing affordable to a reasonable segment of the market.

To stimulate the construction of "for-sale" housing (single-family, condominiums and cooperatives), we strongly support the basic provisions of S. 2226 to be implemented as rapidly as possible in fiscal year 1982. Such a program would provide federal assistance to buy-down the mortgage interest rate by up to 400 basis points (4 percent) for five years.

The major elements of the program we support are as follows:

1. FHA-insured, VA-guaranteed and conventional mortgages would be eligible.
2. GNMA would provide support in operating the program.
3. Maximum mortgage limits would be at least equal to FHA 203(b) limits including high-cost area allowances.
4. The assistance would be fully recaptured by the government upon sale or refinancing.
5. The assistance would be secured by a second mortgage to be paid off upon sale or refinancing.
6. Refinancing could occur at any time without penalty.
7. Only newly constructed for-sale units to be used as prinicpal residences are eligible.
8. Debt service would be increased annually for five years (beginning in the second year) by 0.75 percent of initial mortgage amount. The entire amount of the increase would be used to reduce the principal obligation.
9. Amortization based on a 30-year fixed-rate mortgage at market rate.
10. Program level of 400,000 to 500,000 units authorized.
11. Program would expire if interest rates dropped to 10 percent. Assistance would be phased-down from 4 percent to zero as market rate goes below 14 percent.

Let me give you an example of how this program would work. The interest rate for the first five years would be reduced from 15.5 percent to 11.5 percent on an FHA-insured loan.

On a $65,000 mortgage, this would reduce the monthly payment in the first year from $848 to $644, qualifying 7.8 million additional families. Combined with the interest assistance feature of the program, mortgages would have a growing equity feature. During the first five years of the loan, annual payments would increase by $488 (about $40 per month). However, those increases would be applied to the principal rather than to interest, allowing the mortgage to be paid off entirely by the end of the 19th year. The example assumes that at the beginning of Year Six, the loan will be amortized at the original market rate of 15.5 percent. If the market rate falls and the owner chooses to refinance at the end of Year Six, the loan could be paid off more rapidly. Mr. Chairman, I believe that in today's environment, the growing equity mortgage represents a very positive consumer-oriented instrument. (See chart attached as Exhibit "B".)

For a 450,000 unit program, the government assistance would be paid in five increments for a total cost of just over $5 billion over the length of the assistance period. The new building activity would generate $4 to $5 billion in direct total tax impact to the federal, state and local governments, which would in large measure offset the cost to the Treasury.

The secondary impacts are very significant, but are difficult to calculate in dollars. These include reductions in unemployment compensation, food stamps and other public assistance payments. The major ripple effect in terms of job expansion in other sectors of the economy would provide a total economic impact of $40 billion to $54 billion. As important, this program would restore homeownership opportunity for many young families who have been priced out of the market.

Mr. Chairman, as you said when you announced this program, "Housing has always led us out of a recession before, and it will do so again with this program . . . If we don't do something now to preserve housing related jobs, when recovery comes, there won't be enough people building homes and there will be terrific inflationary pressures just as there were after the 1975 recession."

Mr. Chairman, the most important point to make regarding this type of program is timing—the need for immediate action by Congress and the Administration so that that stimulus could begin to take effect during this years' building season. In order to allow builders time to plan and work, such a program would have to be in place and activated by June of this year. I know that is a tight time frame for Congressional and Administration action, but I believe it is important for you to know what needs to be done in order to achieve the intended result.

There are a number of specific recommendations we have regarding this legislation.

First, the flat mortgage limit of $67,500 would make the program virtually unworkable in many areas of the country. We have reviewed the IRS Average Area Purchase Price "Safe Harbor" limitations (which represent 90 percent of the average purchase price for new homes in the area) and find that high-cost areas are not restricted to any region of the country. The following chart shows a sample of these areas

Area and new home price

Danbury, Conn., SMSA	$91,300
Norwalk, Conn., SMSA	119,800
Stamford, Conn., SMSA	142,000
New Orleans, La., SMSA	93,000
Detroit, Mich., SMSA	99,300
Minneapolis-St. Paul, SMSA	93,200
Nevada (all areas)	98,000
Newark, SMSA	107,900
New York, SMSA	93,600
Nassau-Suffolk, N.Y., SMSA	91,200
Tulsa, Okla., SMSA	95,600
Dallas-Fort Worth, Tex., SMSA	111,400
All areas of Utah (minus Salt Lake, SMSA)	91,700
District of Columbia, SMSA	100,100
Orange County, Calif	116,400
Los Angeles County, Calif	107,100
San Diego County, Calif	107,700
San Francisco-Oakland, Calif	126,900

On a $90,000 purchase price, a buyer would have to make a downpayment of at least 25 percent ($22,500) to meet the $67,500 mortgage limit. This payment level seems unrealistic and is beyond the means of most homebuyers even if they could qualify under the $30,000 income limitation. We would recommend the FHA 203(b) limits with allowance for high-cost areas as a more realistic approach to this issue.

Second, in line with the first recommendation, we would suggest that the income limit be based upon a precentage of the median income in the area. A limit of 140 percent of median area income would be reasonable since the national limit would be about $31,000 to $32,000 (assuming national median income of $22,500) and this would allow for regional variations in income.

Third, because of the urgent emergency nature of the program, we would recommend that the Congressional review process for HUD regulations be waived for this program. We share the view expressed in the bill that HUD should have 30 days to begin making commitments under the program.

Mr. Chairman, we recognize that there are other housing needs which must be met in a fiscal year 1983 housing program. We intend to address the these at length during the Subcommittee's hearings on the housing authorization bill.

Regarding multifamily production, I believe that the most significant action that could be taken to create jobs and stimulate construction would be to push out the HUD and Farmers Home pipeline as quickly as possible. I am referring to Section 8, Section 202, Section 515, tandem and public housing construction. Mr. Chairman, I recognize that this would represent a change in Administration policy. But the pipeline is the only source of production that could move this year and have an impact on employment and the overall economy. We were pleased by the action of the House HUD Appropriations Subcommittee to deal with the pipeline under the administration's rescission request last week.

Mr. Chairman, we in the housing industry are truly at the mercy of Congress and the Administration at this critical time. What is needed is immediate passage of legislation, such as the Chairman's bill, that addresses the current crisis in housing and the economy.

I am very encouraged that you and others on this Committee have recognized the importance of a recovery in housing to the national economy. You should be proud of the outstanding work of this Subcommittee's staff—both majority and and minority. We look forward to working with you and with your staff—as rapidly as possible—to fashion a viable legislative package. I am most grateful for the opportunity to appear before you today, and would be pleased to answer any questions you may have.

ATTACHMENT A

IMPACT OF LUGAR BILL WITH NO SUBSTITUTION EFFECT

[Units: 360,000 single family; 90,000 multifamily; 450,000 total units]

	Single family	Multifamily	Total
Employment impact (in man-years):			
All industries	550,000	102,000	652,000
Construction	196,000	39,000	235,000
On site	164,000	34,000	198,000
Off site	32,000	5,000	37,000
Other industries	280,000	55,000	335,000
Manufacturing	124,000	30,000	154,000
Wholesale trade, transportation and services	111,000	19,000	130,000
Mining and other	45,000	6,000	51,000
Land development	74,000	8,000	82,000
Wage impact (in billions)			
All industries	$10.2	$2.0	$12.2
Construction	4.2	.9	5.1
On site	3.6	.7	4.3
Off site	.6	.2	.8
Other industries	4.4	.9	5.3
Manufacturing	2.0	.5	2.5
Wholesale trade, transportation and services	1.4	.3	1.7
Mining and other	1.0	.2	1.2
Land development	1.6	.2	1.8
Value per unit			
Single family			72,000
Multifamily			55,000
Total economic impact (including multiplier) (billions):			
Single family			45.9
Multifamily			8.3
Total			54.2
Tax impact (in billions)			
Total tax impact, all levels	$4.60	$0.88	$5.48
Total Federal taxes	3.95	.74	4.69
Federal personal income tax	1.28	.23	1.51
Federal corporate income tax	1.32	.26	1.58
Builders	1.01	.19	1.20
Suppliers	.31	.07	.38
Social security tax	1.35	.25	1.60
State personal income tax	.18	.03	.21
Local real estate tax	.47	.11	.58

Source: U.S. Department of Labor, Bureau of Labor Statistics. Internal Revenue Service. Compilation by Economics Division, National Association of Home Builders.

IMPACT OF LUGAR BILL WITH SUBSTITUTION EFFECT

[Units: 264,000 single family; 66,000 multifamily [1]; 330,000 total units]

	Single family	Multifamily	Total
Employment impact (in man-years):			
All industries	403,000	75,000	478,000
Construction	144,000	29,000	173,000
On site	120,000	25,000	145,000
Off site	24,000	4,000	28,000
Other industries	205,000	40,000	245,000
Manufacturing	91,000	22,000	113,000
Wholesale trade, transportation and services	81,000	14,000	95,000
Mining and other	33,000	4,000	37,000
Land development	54,000	6,000	60,000
Wage impact (in billions)			
All industries	$7.5	$1.5	$9.0
Construction	3.1	.7	3.8
On site	2.7	.5	3.2
Off site	.4	.2	.6
Other industries	3.2	.7	3.9
Manufacturing	1.5	.4	1.9
Wholesale trade, transportation and services	1.0	.2	1.2
Mining and other	.7	.1	.8
Land development	1.2	.1	1.3
Value per unit (dollars):			
Single family			72,000
Multifamily			55,000
Total economic impact (including multiplier) (billions):			
Single family			33.7
Multifamily			6.1
Total			39.8
Tax impact (in billions)			
Total tax impact, all levels	$3.37	$0.65	$4.02
Total Federal taxes	2.90	.55	3.45
Federal personal income tax	.94	.17	1.11
Federal corporate income tax	.97	.19	1.16
Builders	.74	.14	.88
Suppliers	.23	.05	.28
Social security tax	.99	.19	1.18
State personal income tax	.13	.02	.15
Local real estate tax	.34	.08	.42

[1] For sale units such as condominuims, cooperatives.

Source: U.S. Department of Labor, Bureau of Labor Statistics. Internal Revenue Service. Compilation by Economics Division, National Association of Home Builders.

ATTACHMENT B

COMBINED GROWING EQUITY MORTGAGE WITH FEDERAL LIMITED RECAPTURABLE ASSISTANCE

[Market rate, 15.5 percent; assistance rate, 11.5 percent (1st 5 yr)]

	Outstanding balance on mortgage	Principal plus interest		Reduction annual principal	Annual income	Principal plus interest as percent of income	Property value per unit	Owner equity per unit	Annual assistance per unit	Cumulative assistance per unit	Ratio of equity to assistance
		Yearly	Monthly								
Year 1	$90,000	$10,692	$891	$149	$42,768	25.00	$99,000	$9,000	$3,600	$3,600	2.50
Year 2	89,851	11,367	947	849	44,906	25.31	103,950	14,099	3,593	7,193	1.96
Year 3	89,002	12,042	1,004	1,551	47,152	25.54	109,148	20,146	3,560	10,753	1.87
Year 4	87,451	12,717	1,066	2,256	49,509	25.69	114,605	27,154	3,499	14,252	1.91
Year 5	85,195	13,392	1,116	2,964	51,985	25.76	120,335	35,140	3,409	17,661	1.99
Year 6	82,231	14,067	1,172	3,673	54,584	25.77	126,352	44,121	0	0	2.50

Note: Paid off at end of year 19. Total payments over life of mortgage equal $257,366. Payments for a 30-year fixed-rate mortgage at 15.5 percent over life of mortgage would be $422,663.

Assumptions: Income increase compounded 5 percent annually. Market Value compounded 5 percent annually. Debt service increases $675 annually for 5 years. Permanent mortgage: 30yr, FHA, 15.5 percent rate. Temporary assistance rate 11.5 percent. Annual assistance equals diffenence between assistance and market rates times the outstanding balance.

Mr. **Napolitano**. Again, let me sum up by saying time is very critical. If we do not get this out quickly, we've lost this year as far as the building industry is concerned and the economy and the American people will suffer. I'll be happy to answer any questions you might have.

Senator **Lugar**. Thank you very much for your testimony.

The Chair would like to recognize Robert Teeter, president of Market Opinion Research, Detroit, Mich., for his testimony.

STATEMENT OF ROBERT TEETER, PRESIDENT, MARKET OPINION RESEARCH, DETROIT, MICH.

Mr. **Teeter**. Thank you, Mr. Chairman.

NATIONAL PUBLIC OPINION SURVEY

I'd like to thank you for inviting me to testify this morning and I'd like to report to you on some findings of a national public opinion survey that we conducted on the subject of housing and home buying in January of this year.

The study was commissioned by the National Forest Products Association and was conducted among 1,500 adults between January 14 and January 22 of this year.

The purpose of the study was to identify the social, economic, and psychological values Americans attach to homeownership; to estimate homeownership demand and market in 1982 relative to their desire and their ability to buy a home; and to relate the values of homeownership and the desire to purchase a home to their perceptions of Federal economic and housing policy.

Homeownership continues to be one of the most important values that Americans have—75 percent of all Americans rate homeownership as an extremely or very important goal or aspiration to them. It is always mentioned very high, either second, third, or fourth, on a list when we ask people to identify those elements that supply them with a high quality of life. Eighty percent believe that fewer Americans will be able to own their own home at any time in their lives than they have in previous generations. Seventy percent of those people who have children now in the first home buying generation doubt that their children will ever be able to buy a home as they did when they were young.

Clearly, housing and homeownership is one of those public concerns and issues that is becoming of much greater concern very rapidly during the last part of 1981 and early 1982.

There are three particular components to attitudes and values that Americans attach to home buying. I think they are worth mentioning.

First of all, as a quality of life. For most Americans, homeownership equates with better neighborhoods, a better quality of life for themselves and for their children. Over 80 percent of Americans believe that homeowners generally have more privacy. They tend to live in better neighborhoods that are better maintained, that homeownership provides a sense of involvement in communities and in neighborhoods, and over 70 percent believe they can provide a better environment in which to raise children.

Second, Americans still believe in homeownership as an important investment. Most Americans still believe that owning a home is a good hedge against inflation and a key way to save for retirement. Eighty-eight percent of all Americans believe that owning a home in 1982 was still a good investment. Over 80 percent feel that homeownership is a good way to save for retirement. Seventy-four percent feel they can stay ahead of inflation by owning a home. Homeownership as a personal goal and aspiration is also important. Almost all Americans, 85 percent, agree that homeownership should be available to every American who desires to own a home.

When we look at the market in early 1982, it segments itself into three particular components. First, 11 percent of the households in the country today would like to or clearly are interested in moving this year. Second, an additional 23 percent of the households have some desire to move either this year or some time in the subsequent 2 years. Finally, 64 percent are not in the market now nor intend to be at any time in the next 5 years.

This means that about one-third of the households in the country are somewhat in the market for a house either this year or in the relatively near future while two-thirds are not at this point in time. This is consistent with census data and other data that indicates that about two-thirds of the Americans have moved in the last 10 years and about half of all households have moved in the last 5 years.

There are some interesting characteristics to those people who comprise the market now and in the immediate future. Among that 11 percent who are the most likely movers this year, they are split about equally between those who intend to purchase a home and those who intend to rent the home they move to. Sixty-four percent, almost two-thirds, are under 35 years of age. Seventy-eight percent have a total family income of under $30,000. This breaks down to 16 percent of family incomes of under $10,000, 36 percent with incomes of $10,000 to $20,000, and 24 percent with incomes of $20,000 to $30,000. Only 25 percent of this group currently own their own home now.

At the next level up, those who might move this year and would hope to over the next 2 years, 61 percent intend to purchase a home, while only 28 percent would prefer to move to rental housing. Only 40 percent are under 35 years of age; 30 percent are between 35 and 54. Certainly only a small group of these people are in the retired category and are moving for that reason. Seventy-five percent have total family incomes of $35,000 or less; 59 percent of them currently own their own home. Of those people who don't want to move, 84 percent currently own their own home and are considerably older—76 percent are over 35 years of age.

With the economic realities these people are confronted with in buying a home in 1982, I think—to get to the most significant data as it relates to this legislation—45 percent of the likely movers and 60 percent of the possible movers say that economic conditions, particularly mentioning high interest rates, are having an inhibiting impact on their plans in 1982. Only 28 percent think that 1982 will be a good year to buy a home. The same 28 percent, almost the same number and almost the same people, think that interest rates will not come down at all during 1982. Two-thirds of this group don't think there's any chance that interest rates will come down either this year or in the near future.

MORTGAGE RATE PROBLEM

These attitudes are particularly strong among the younger and mid- to low-income consumers who are very heavily represented in the people who would otherwise be in the market in 1982. It is interesting that in the midst of the recession and great and growing concern over unemployment, more people, 63 percent, are confident of their ability to go out and find a new job if they had to than they are confident of their ability to buy a new home—only 49 percent. Clearly, I think this is the most important data of all. Mortgage rates are the problem—43 percent think they can find a home at a price they can afford. Only 8 percent of all the likely buyers and 7 percent of all the potential buyers are in the active market at 16-percent interest rates.

However, as mortgage rates fall below 16 percent, we begin to add significant numbers of people in the market. At 15 percent, we add 7 percent more of the potential buyers. Now I'm giving you this group that's about a third of the total households. At 14 percent, we add 5 more percent. At 13 percent, we add another 5 percent; and at 12 percent, an additional 17 percent. The movement from 16 to 12 percent of mortgage interest rates increases the active market of people actually out looking for a home this year by over four times.

Interestingly and importantly, the group that this legislation is aimed at, those with incomes of under $30,000, only 6 percent are in the market at 16 percent, but that increases to 37 percent who would be in the market at 12 percent. It is also evident that current high mortgage interest rates represent a psychological as well as an economic problem.

Above $15,000 annual income, there is no relationship between income and willingness to pay various interest rates. It appears that 12 percent is becoming what we used to think of as consumers as the old 6 percent—that is the standard rate that people believe that mortgages should be and the standard interest rate that people psychologically find acceptable.

Clearly, members of the public recognize on a personal level how high interest rates have restricted their ability to purchase their first home or upgrade the home when and if they desire.

To the degree that the administration, Congress, and various Federal agencies can implement programs or policies that will reduce interest rates and free up mortgage loan funds, Americans who desire to purchase homes will be much more willing to enter the market. Of all Americans 42 percent think the Federal Government should do everything possible, more than it is now doing, to help people buy homes. Another 33 percent believe that the government should continue to strengthen the current housing programs like FHA and VA; and only one in six Americans feel that the Federal Government should be doing less than it is to encourage homeownership.

Senator LUGAR. Thank you very much, Mr. Teeter.

I will now call upon Senator Sarbanes of Maryland, who has entered this hearing, for any comment or opening statement that he might have.

STATEMENT OF SENATOR SARBANES

Senator **Sarbanes**. Mr. Chairman, I only have a brief statement and that is that I think it's imperative for the housing sector of the economy to be put back on track. It's obviously been a major contributor to the downturn and to the deepening recession which we confront. It's very important that this committee evolve a legislative approach which will contribute to restoring the housing sector and meeting the housing needs of the public.

I gather that Mr. Teeter's statement will be made available to us in a written form at some point; some of those survey figures are enormously important and of great assistance. We have to craft a piece of legislation that really addresses the housing needs facing us, that meets those housing needs and at the same time obviously provides an economic stimulus which the economy desperately requires.

What's happened in housing has been counterproductive in every respect. I don't see that it's made any contribution toward addressing any of our economic problems, and it has compounded a whole range of problems which we are now confronting.

Senator **Lugar**. Thank you very much.

If I can have the unanimous consent of my colleagues, at least for the first round of questions, let us restrict ourselves to 5 minutes because of the additional panels giving testimony this morning. If there are additional questions, we will have another round. Let me proceed with this question to any of the three of you.

CRITICISMS OF LEGISLATION

Two of the criticisms of the legislation that the committee is taking a look at today are that it would not stimulate new housing or the bill is not crafted in such a way that it's absolutely certain that new housing is what we're after. In short, some critics have said in order for the employment effect to occur, we must be talking about starts that happen as a result of this bill as opposed to inventory or other aspects of housing.

The second criticism is the one offered today very cogently by my colleague, Senator Proxmire. That is that clearly we are reducing interest rates for potential home buyers, hopefully 400,000 of them, but this does call for a great deal of credit extension. This means that 400,000 new mortgages are being made by lending institutions in the country and there is a question of capital sufficiency in the country or what the effect of that type of new activity in new housing might mean with regard to credit markets generally.

Can any of you offer any help to us on those two problems?

Mr. **Ruckelshaus**. Mr. Chairman, I think those are both very important and crucial questions and they go to the question raised by Senator Proxmire in his opening remarks, namely, will this work? If we simply substitute for people who will purchase homes anyway and who are included in the projections of how many homes would be purchased this year—something in the neighborhood of

900,000—would we really be accomplishing anything? Obviously not. So this program needs to be crafted in such a way that it will in fact cause incremental housing starts. The only way we're going to put more people back to work is by producing more homes on top of those that will to be produced and will be purchased.

There is a good deal of work now going on to attempt to respond to your question through whatever economic modeling can be provided, through empirical data to buttress the provisions in the bill. I think it is a terribly important question and if in fact the bill is to be pursued as an economic recovery program, it must work. It must put people back to work.

Clearly, as I think Mr. Teeter's poll shows, when mortgage interest rates come down in the neighborhood of 12 percent, an awful lot of people move into the market who are now walled off, who now in fact cannot afford to buy new homes. This is precisely that group of people that this program is aimed at.

There are a good number of homes in inventory now that are priced higher than would be affected by this bill, with the $67,500 mortgage limit and the $30,000 income limitation. And I think what everyone interested in this legislation must do is address that question as honestly and straightforwardly as possible and determine to the extent it is possible to predict just how many incremental houses will be built and make sure whatever provisions are necessary to insure the maximum number of new houses are in fact in the legislation.

All of the information that we can gain, either empirically or through economic analysis or through the polls, indicate that the bill as currently fashioned will have a maximum incremental effect. There may need to be some adjustments as this data is refined to insure that in fact that incremental impact is felt.

EFFECT ON THE CREDIT MARKETS

In terms of the second question, namely, what will be the effect on the credit markets, that I think goes to the issue of the urgency of this legislation.

If we let the legislation simply take a course through the Congress so that sometime in the early fall when the normal authorization bills would come out this legislation would pass, we may well miss a window that we think now exists in the credit markets where there will be room for this kind of program.

Over the next 3 to 5 months, it appears that there will be adequate room in the credit markets to take care of the some $25 to $30 billion impact which this bill would have. Credit markets can accommodate this kind of legislation, it will afford a stimulus to new home construction without having the impact of crowding out other demands on credit. And if in fact the feedback occurs as we think it will on the deficit, you will also be reducing the deficit and reducing that demand on the credit markets as well.

So I think we have a unique opportunity here, both in terms of a bill that will affect incremental housing starts and also a window as far as the credit markets are concerned, with room to accommodate this new demand.

Senator **LUGAR**. Mr. Napolitano.

Mr. **Napolitano**. First of all, I would like to second everything Mr. Ruckelshaus said. I fully agree and concur with his comments.

Not to be repetitious, I would like to point out to the subcommittee a personal experience which is typical of what's happening around the country in most areas. I travel extensively around the country talking to builders and realtors and people in general. This was in Virginia Beach, Va., about the early part of December of last year.

When the FHA-VA rate was about 15.5 I believe and there was a strong indication that the following week the rate would be reduced to 14.5 percent, through the buydown process, most builders were buying down to about 13 or 13.5. But with the pending downturn of the FHA-VA rate, builders decided that week in that area to advertise at 12, buy it down, anticipating the 1 point turndown. As a result of that, 40 to 50 homes were sold in that week.

The following week the rate did not come down as anticipated and they had to pull their ads out of newspapers. The people did not come out to buy. There was the normal number of 5 or 10 sales made during that period of time.

The point I'm making, sir, is that those people who came out at 12 percent could not afford it when it went up to 13 percent. Twelve, as Mr. Teeter pointed out, seems to be the threshold now of people coming back into the marketplace in much larger numbers.

Senator **Lugar**. Senator Proxmire.

Senator **Proxmire**. Gentlemen, first, I want to congratulate you on your statements. I think they are three excellent statements and very, very helpful, and we're certainly in your debt.

Just one little nitpicking suggestion, Mr. Ruckelshaus, on page 5 of your statement, you say, "An increase of 500,000 housing starts, for example, create 800,000 jobs for a 1-percent reduction in the Nation's unemployment rate."

I think you mean 8-percent reduction, don't you, because—or a 10-percent reduction? If you had a 1-percent increase in employment but a 10-percent reduction roughly in unemployment.

Mr. **Ruckelshaus**. Yes, you're right. Thank you for that correction.

Senator **Proxmire**. Now in your response to Senator Lugar you indicated that you thought there were some people who would move into housing now who wouldn't be eligible at the present time with 16 percent interest rates, but at 12 or 13 percent they would be. That's logical.

The trouble is that others get crowded out unless you have an increase in the availability of credit. If you're going to have $26 billion of additional credit demand as a result of this bill and you get no accommodation from the Federal Reserve, doesn't it follow as day follows night that as a result you're going to have pressure on interest rates that would go up? Other people will simply be crowded out primarily in housing but also in automobiles and so forth, so you will have no net increase in employment. Now maybe the Federal Reserve will accommodate, and they should perhaps—you can make a strong argument that they should. As you say, and you made a very brilliant argument here, you're operating at far below capacity. There's no pressure on prices if you have another 400,000 housing starts. The housing industry can do that standing on its head. They could probably provide 800,000. You've got the people looking for work. You've got the supply. You know that better than anybody in the room. You've got everything available and if we had 400,000 additional net housing starts you wouldn't have any additional pressure on price, would you?

Mr. RUCKELSHAUS. No, that's right. Senator, from everything we've been able to discern we have more than adequate capacity to absorb these additional starts without any pressure on prices at all.

Senator PROXMIRE. But you don't have the credit available and if you're going to demand that $26 billion of credit and get no accommodation from the Federal Reserve, why isn't the result inevitably higher interest rates?

WINDOW OF CREDIT AVAILABILITY

Mr. RUCKELSHAUS. Well, to get into this argument about what the Federal Reserve ought to do would last long past this morning, but my response to the chairman was that it appears that over the next 4 or 5 months we do have a window in credit availability, that this additional $27 billion to $30 billion effect would not crowd out.

Senator PROXMIRE. Where do you get the window in credit availability?

Mr. RUCKELSHAUS. Well, the interest rates—who knows where interest rates are going? I can make a prediction, as well as anybody can. Where we have this historic gap between inflation and where long-term interest rates now are, it does appear that over the next 4 or 5 months there's ample reason for short rates to come down.

The real problem and the reason for the urgency of this legislation is the long rates may well not come down because of the psychological factor of the potential for increased inflation or the volatility of the monetary policy itself will keep them up there. That's one of the big concerns that we have about housing's participation in this recovery.

Senator PROXMIRE. But I cannot for the life of me understand how you can have an additional whopping increase in demand which this would provide—it makes a lot of sense in all kinds of ways if there's accommodation, but if there isn't, there isn't any additional credit. I don't know how you can evade the fact that interest rates are likely to go up and therefore crowd others out and the credit has to come from somewhere. It will come primarily, as I say, from other housing starts or it will come from the automobile industry or the farming industry and other people who desperately need credit and won't be able to get it, just as the Federal Government is crowding it out also.

Our problem now, as you know, is that the off-budget borrowing by the Federal Government and the deficit borrowing by the Federal Government are now taking about one-half of all new credit, not $1 out of $6 as it was in 1973, but $3 out of $6. Here's another Federal initiative which will increase the amount that the Federal Government will influence and direct as far as credit is concerned.

Mr. RUCKELSHAUS. Well, Senator, if interest rates did not come down during the period in which this program is in effect, then it will certainly not have as much effect as is hoped.

Senator **PROXMIRE**. Well, this is one of the elements that would keep them from coming down. If you're assuming there's a window here and that they will come down, then they would come down more without this legislation. Is that right or wrong?

Mr. **RUCKELSHAUS**. I think what we are seeing is long rates not as likely to come down even during this window period as short rates. My thesis is that the problem associated with long rates is as much psychological as it is economic and people are so concerned about the potential for monetizing these huge deficits and for monetary policy at some time breaking and more money being released and setting off another round of inflation, that they are simply going to leave those long rates up there and you're not going to see a reduction in mortgage interest rates sufficient to trigger this demand; but in fact a program like this could bring mortgage interest rates down, put people back to work, have the feedback impact on the deficit itself which would decrease governmental demand.

Senator **PROXMIRE**. It will have the feedback provided there's a net effect in more jobs and——

Mr. **RUCKELSHAUS**. That's right.

Senator **PROXMIRE**. That's the case you're tailoring.

Let me just ask Mr. Teeter and Mr. Napolitano this question, if I just have a minute or so left. It seems to me that this legislation does not, as I understand it, require as eligibility that people be buying their first homes. I thought it did, but I understand it does not. And there's no prohibition against people buying a second home provided they occupy it.

Mr. **RUCKELSHAUS**. That's correct.

Senator **PROXMIRE**. In view of the fact this is a very attractive opportunity, I would think there would be just all kinds of families that would like to get a 4 percent cut in the mortgage and be willing to move in. Why shouldn't we provide that kind of eligibility limitation so it would be available to people who are buying one home and families buying the home for the first time? Would you have an objection to that kind of amendment?

Mr. **NAPOLITANO**. Yes. We would be concerned about that for two reasons. One is mobility of people. Second, you take areas such as Florida or some of the Sun Belt areas, perhaps where some elderly people are trying to retire, they are not necessarily trying to sell their homes, they're trying to move down to another area. If this doesn't apply to them—this is the lower income group I'm talking about, not wealthy by any means—the average person who just wants to retire and sell their larger home and get into a smaller unit—this would prohibit them doing that. Plus I believe the higher interest rates would prohibit them from selling their units as readily as you think might happen because they have this opportunity. Now as the interest rates come down, of course, that would help them.

Mr. **TEETER**. I think the one thing you would do by doing that is you would reduce the market. If the purpose of the legislation is to bring more people into the market and generate a more active market, then by doing that you're going to cut out a segment of that group. I think the evidence is that largely you would be attracting many first-time buyers. Of that group that is most likely to buy a home under this kind of legislation to bring interest rates down to 12 percent and who have incomes of under $30,000, only about 25 percent of those people currently own a home now. 75 percent of them would be people who do not own a home now. It looks like about half of that 25 percent would be at the very top of the group who would come in. So probably you're looking at no more than 12 or 15 percent of the people in that prime group who are currently homeowners and the rest of them—you would, I think, attract largely people who are first-time buyers.

Senator **Lugar**. Senator Dodd.

Senator **Dodd**. Thank you, Mr. Chairman.

Let me just follow on with Senator Proxmire's inquiry about the interest rates situation because obviously that's the linchpin here. If those rates don't come down, then the program has got real problems. We're talking about a 5-year program with an income limitation of $30,000 on a family. Wouldn't you agree that the likelihood is that the constituency that would take advantage of this would have to be very near that $30,000 income level? Given the fact that this is a one-time program and given the tentative nature of interest rates and the inability of people to pay for that cost of money, that after 5 years, you could be faced with the situation where people at the lower part of that income level would be right back where they are today, in effect, in terms of carrying the mortgage. So, how likely are institutions going to be to accept that constituency that falls in the lower part of that middle income range, given the fact that they could be put in the position where they would have to assume, after a period of 5 years, the additional 4 points or 5 points, or whatever interest rates are?

Mr. **Ruckelshaus**. Senator, one of the features of the bill is that there are some assumptions in it in terms of where people's income is today and how it will appreciate over the next 5 years. There is also a graduated increase in their mortgage payment itself over the 5-year period. So they are not suddenly faced with a jump in mortgages in the sixth year from where it is now. And if those assumptions about their income increases and the assumptions about their ability to pay over that 5-year period are correct, then they will be qualified just as anybody else would be for a mortgage. They still will have to qualify and the qualifications will obviously be affected in part by the subsidy.

Senator **Dodd**. Don't we assume that the people who are closer to the $30,000 ceiling have a greater likelihood for salary or income increases than those at the $10,000 to $15,000 range?

Mr. **Ruckelshaus**. Well, I think in general that's probably true, yes.

RENTAL HOUSING

Senator **Dodd**. Let me also ask, if I may, what distinction you would offer—I ask all three of you to comment on this—we talked about an economic stimulus being created as a result of the construction of single family homes, manufactured housing and cooperatives. Would you explain to me why rental housing could not also be an economic stimulus if cooperatives are?

Mr. **Napolitano**. We have considered that and, yes, we are concerned about the rental market as well, as you very well pointed out the problems in the rental market. However, moving the pipeline would be a more immediate stimulus for job creation and other economic stimulation in the rental area.

Senator **Dodd**. But you don't oppose them?

Mr. **Napolitano**. We don't oppose them. We want to see multifamily and we believe there's a tremendous shortage out there and all the figures you quoted earlier are correct. And, incidentally, Senator, I do want to congratulate you on agreeing with the concept of this bill. I hope you will go along with it almost in total, but at least you agree with it conceptually. And again, all the things you said are definitely true.

Senator **Dodd**. But there really isn't any distinction between the construction of a cooperative unit and a rental unit in terms of economic stimulus?

Mr. **Napolitano**. A cooperative as we would look at it is something where someone buys a unit which is a single family unit.

Senator **Dodd**. Do you get more jobs out of building a cooperative unit than you do a rental unit?

Mr. **Napolitano**. Only in the sense you're able to bring the costs down by building a higher density than you would perhaps on a single family lot. That would be the only way you could create more jobs. But condominiums and cooperatives are included in what we're talking about here.

Senator **Dodd**. Mr. Ruckelshaus, do you want to comment on that?

Mr. **Ruckelshaus**. Well, I would go back to the chairman's opening remarks that this bill could really be in any committee. It just happens to be here because housing is uniquely situated to lead us out of this recovery or spark the recovery, and the single family area is where you get the most jobs in return for the Government stimulus and I think that's the rationale for the bill being fashioned as it is. It in no way is any commentary on your pointing out the need in the rental housing and in other areas.

Senator **Dodd**. I would just point out that we've got the House, the other body, which has a piece of legislation which is a bit more comprehensive than this. It includes this, a good part of it, and it seems to me that we might take that into consideration when trying to expedite the process. Legislation requires concurrence by both Houses and if we're trying to move something quickly, it might make more sense to try and get into synch with the other body when taking into consideration all of the issues affecting housing, recognizing we can't do all things obviously, but if we're truly in need of moving something quickly—and I agree we are—I think we've got to move quickly on this, but I think it's also important in the process that we take into consideration obviously the jobs—19 percent unemployment in the construction industry as well as those to be housed, and recognize that whatever gains we may make in return, economic benefits, as a result of this program, that that could be easily all lost if in fact we neglect that other sector of the economy, that other sector of the country that is in desperate need of housing, whether it be rental or public housing, and all of a sudden be faced, as I'm fearful of—faced with that situation where we have some riots, to be quite honest about it. That can happen. We all know about it and its potential. The pot is boiling out there. And then Congress reacts, and what we do is we throw out a life support system, spend billions of dollars to try to recover after we've got a burned-out city on the west coast or the east coast of this country as a result of these problems.

So I would hope that we would be able to take into consideration the legitimate needs of those that are out of work that we need to put back to work to stimulate the economy, but also recognize that there are millions of families in this country that, unfortunately, can never have the opportunity of owning their own home, but they do need adequate shelter, and there are other needs to be met through rental construction and other vehicles.

My time is up, Mr. Chairman.

Mr. RUCKELSHAUS. Senator, I might just comment that you correctly point out an area of great controversy between this body and the House and the administration. I guess realistically, if this bill is not viewed as an emergency, if it is not brought out of the Congress and signed by the President very quickly, then the credit window—the impact in the summer is going to be gone. And if we inject these other questions, which you very correctly raise and which are matters of great controversy in this body and the House and the administration, I'm greatly concerned that this opportunity will be lost. We will spend weeks and even months in debate over the merits or demerits of your approach or Congressman Gonzales' approach and we will not get this potential stimulus to the economy that this bill provides.

Mr. NAPOLITANO. Senator, may I just comment briefly on this? Senator Dodd, I want to assure you that the homebuilders of America, the National Association of Homebuilders, fully understands what you're saying and in no way are we saying to the other people of the country that "you can't have housing" or "we're not concerned about you." We are very much concerned about that.

However, as Mr. Ruckelshaus just pointed out, it is important on timing. I testified last week in Senator Gonzales' hearing and will be testifying again before this subcommittee on the full HUD appropriations bill. We are concerned about that and we will make our views known. We have to house all Americans, but this is the only thing we know of now that can get the economy moving again, and that's why we're behind this bill at this time for emergency relief.

Senator LUGAR. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Gentlemen, I'm interested in addressing the question of the geographic spread of the units under this program. In other words, how does the program insure that the benefits are not all concentrated in a few places in the country and that there's participation on a fairly equitable basis across the country, one, to meet existing housing needs; and, two, to address the jobs and economic stimulus aspect of the program?

ALLOCATION FORMULA

Mr. RUCKELSHAUS. You have, Senator, an allocation formula in the bill itself and it's my understanding that there are some who have looked at the allocation formula who wonder whether it's properly fashioned to maximize the impact—the economic stimulus that the bill is aimed at.

I would think that, as I suggested in my opening remarks, that as we understand better the potential effects of this bill, we should all insure that the allocation formula does in fact have the maximum economic stimulus effect. The kinds of questions that are raised about the formula as it appears in the bill are important and I think should be examined very carefully to insure that that impact will occur.

The money is allocated on the basis of one-third according to the ratio of the population of each State to the population of the country, one-third on the basis of the ratio of the decline in one to four family housing starts measured from 1978 to 1981 of each State—again that ratio and decline in relation to all States—and then 1/3 is allocated on the basis of unemployment, again a ratio of one State to all States.

To whatever extent those allocation formulas will not maximize the economic impact of this bill and do so in an equitable fashion, then I think they should be changed. But that is something that this committee must consider.

Senator **Sarbanes**. I was really asking a more complicated question because I was relating the allocation formula with the limits on mortgage and income. It gets pretty tricky, I gather, Mr. Napolitano, though I had to slip out of the room when you made your statement and I did look through it very quickly, and I gather you addressed this. In some areas of the country those limits really close out a good part of the market, and there won't be anyone there to take advantage of the program. At least, far fewer in the overall range of the population in those areas will be able to participate in the program than is true in other areas of the country.

So you may have a real mismatch. It seems to me that roughly the same proportion of people generally across the country ought to be able to get into this program. Is that a premise you would agree with or not? Let me ask that question to start with. Maybe there's disagreement on that.

Mr. **Napolitano**. Well, I believe, first of all, that the limit should be raised, as I pointed out in my testimony, to do exactly what you're saying so more of the country will be able to participate. I believe that perhaps where you have the highest unemployment, that they should have some benefits from it. Also in the area of starts, where they're way down, they should have some benefits.

I would be concerned that after the allocations are made, something be put in place to move those allocations rather quickly. If, for instance, an area that has a lot of allocations can't use them because of economic conditions that exist in that particular area—conditions which may not be conducive to even 8-percent interest rates for the moment) those allocations should be moved quickly to other areas of the country that can use them. In stimulating construction throughout the country you will be able to stimulate other industries that will benefit from it very much.

Senator **Sarbanes**. Is your concern that there will be enough response to this program to use it up or do you have a concern that there may be a response well beyond what's available, thereby confronting us with a question of who gets to participate?

Mr. **Napolitano**. Well, I believe if nothing happens with the interest rate, if it doesn't come down by virtue of what Congress and the administration do and the Wall Street people don't respond to that, I believe you'll see more of a demand than what we're anticipating here. However, as the interest rate does come down, as it well should in the future, I believe you will see less of a demand for the program as perhaps some of the lending institutions may go back to other forms of lending. I don't say long-term, 30-year mortgages, but you may find some more instruments on the marketplace that will be more suitable. But for the time being, I would say this program would be in demand and if nothing else happens this would be in greater demand than we anticipate.

Senator **Sarbanes**. Do you anticipate a demand in excess of what would be available, so you would be confronted with a problem of who gets to take part in the program? How would that be answered? First come, first served?

Mr. **Napolitano**. Well, in certain areas of the country I would see that happening; yes. In other areas I wouldn't see that as a major problem because of the economy that exists in that particular area. I believe a formula needs to be worked out. I don't believe it could be strictly first come, first served, although the people who apply for it, who are up to date on their own program and put in an application would obviously have some benefit, but I think it should be done equitably. I can't answer all the questions right here, but it has to be done on some equitable basis.

Senator **Sarbanes**. I see my time is up.

In closing, I want to commend all of the panel for their very helpful statements, but I particularly wanted to commend you, Mr. Napolitano, for the concern you are showing with respect to other areas of housing and the people involved as reflected in your responses to Senator Dodd and also on page 9 of your prepared statement.

Thank you, Mr. Chairman.

Senator **Lugar**. Thank you very much, Senator Sarbanes.

Gentlemen, we appreciate very much your being with us this morning.

The Chair would like to call the second panel, Craig Swan, associate professor of economics, University of Minnesota; Ken Rosen, chairman, Center for Real Estate and Urban Economics, University of Southern California at Berkeley; and Patric Hendershott, professor of economics, Ohio State University.

Gentlemen, we welcome you this morning. I'll ask for your testimony in the order you were introduced. Mr. Swan, would you please give your testimony?

STATEMENT OF CRAIG SWAN, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. **Swan**. Thank you, Mr. Chairman. I have some copies of a statement here. I would like to briefly summarize parts of the statement. You might find it useful to have a copy yourself because there are some tables in it.

Senator **Lugar**. Thank you.

Mr. **Swan**. The current status of the economy in general and the homebuilding industry in particular are very serious and of great concern to everybody. Thus it's understandable that there's a great deal of interest in the proposed interest rate subsidy. At the same time I have some serious reservations about whether the bill is likely to accomplish what its sponsors would like to accomplish, although I have no disagreement with the idea of getting the country back to work and helping an industry that seems to be severely depressed.

IMPACT ON HOUSING INDUSTRY

Some of the claims for the bill, in particular that it will increase housing starts by 300,000 to 400,000 units this year, clearly overstate the impact the program is likely to have. I would like to talk about three elements of the likely impact on homebuilding. Then I will discuss the impact on the national economy, and finally, I will end with some comments about the cost to the Government.

When looking at the impact on the homebuilding industry, the bill is likely to have three effects, all of which have to be summed to get the total effect on construction and unemployment.

The first effect is that the interest rate reduction subsidy is likely to attract some new buyers into the market, buyers who would not otherwise be there under current conditions. This increase in construction activity would clearly decrease unemployment.

The second impact is that a subsidy will also be available to people who would otherwise have bought homes. Given the way the subsidy works, it will make housing cheaper for these people. As a result they are likely to demand more housing, that is bigger homes. This increase in demand is a clear increase in construction activity.

The third impact—a subtraction from the first two—has to do with the impact on nonsubsidized buyers. Senator Proxmire has already made reference to this impact with his concerns about the demand for mortgage credit and mortgage rates. Higher mortgage rates will reduce demand by nonsubsidized borrowers.

If you look at total impact, you should start not with the total number of units that would be funded under the program, but with a much smaller number, that is buyers who would not otherwise be in the market. You next add the marginal increase in houses that subsidized buyers who would have been there anyway will buy because of the subsidy. Finally, you need to subtract the impact on nonsubsidized buyers.

When looking at what the program is likely to do, I think it's useful to first get an understanding of what the program really is. When all is said and done, the interest rate reduction boils down to an interest-free loan to home buyers. That is, the Government is picking up 4 percentage points for the first 5 years in return for a liability that obligates home buyers to pay back the subsidy when the home is sold or refinanced. A useful way to look at the impact of the program is to calculate the effective after-tax interest rate for a subsidized borrower. These numbers are presented in tables 1, 2, 3 and 4 in the back of my statement.

The value of the subsidy depends upon the year in which the home is sold or refinanced, and hence the year in which the loan is paid back to the Government. The value of the subsidy to individual homebuyers also depends upon their marginal tax rate. The first two tables assume marginal tax rates of 20 and 30 percent, numbers I think will be typical of married and single buyers under the program.

The bill is a little unclear—at least the description I saw is a little unclear—as to whether the repayment of the subsidy will be tax deductible. The tax status at the repayment has an effect on the effective after-tax rate borrowers will face. The subsidy reduces interest that a borrower would otherwise pay. While a borrower has lower interest payments, he also has lower tax deductions when repaying the subsidy you're paying the Government for payments it made for you. There is some logic to letting these late interest payments be tax deductible. If they are not tax deductible, then you could have perverse effects for people who, for one reason or another, pay back these loans in the early years of the program.

Net effects depend on marginal tax rates and when the subsidy is repaid. But, if the repayment is not tax deductible, an individual could actually be worse off with the subsidy if he had to sell his home in the first 5 to 7 years of the program. Tables 3 and 4 illustrate this point.

Looking at tables 1 and 2, one sees that 4-percent interest reduction for 5 years comes down to about a 1 to 1.5 percent effective interest rate reduction. That number is similar to the interest reduction that was offered in the Emergency Housing Purchase Assistance Act of 1974 which worked through some Ginnie Mae programs similar to what is being proposed here—at least I imagine the mechanics are similar.

The Ginnie Mae program subsidized 190,000 loans. There was a panel of economists who examined the impact of that program, including Professor Hendershott, Professor Rosen and myself. That panel came to the conclusion that the 190,000 subsidized loans had a net impact on new starts that otherwise would not have been there on the order of only 20,000 to 30,000 new starts, not 190,000. If one applied that ratio to the proposal here, assuming that all the subsidy authority was used, one might expect somewhere between 40,000 to 70,000 net new units, substantially smaller than 300,000. This estimate of 40,000 to 70,000 is only the first of the three impacts I mentioned earlier.

There are two other factors that might lead one to expect a slightly larger effect this time around. One is that the inventory of unsold homes is slightly lower in absolute terms than it was in 1974. As currently drafted, it seems to me that the bill does allow for the possibility of inventory liquidation which would tend to offset any impact on net new activity. In fact, inventory liquidation appeared to have played a very large role in the 1974 bill. This time around, with smaller inventory, there may be a smaller effect in terms of inventory reduction and a larger effect in terms at new starts.

CASH FLOW

The other important distinguishing feature of this proposal from the 1974 proposal is that the proposal today has substantial reduction in cash flow requirements in the early years of the mortgage. To the extent that interest rates involve accurate expectations of future inflation, then by the end of the mortgage the borrower is no worse off with high nominal rates and high inflation than with lower nominal rates and lower inflation. In fact with current tax advantages, the borrower is actually better off with high nominal rates and inflation.

But there is an initial cash flow problem for borrowers, a problem that comes from very substantial mortgage payments. That's why, with interest rates of 15 percent, the 25 percent house payment to income rules seem to eliminate so many buyers. The proposal we're talking about this morning does address the issue of cash flow in the early years of the mortgage and thus might have a marginally larger impact on new starts. Adding up all these effects, the impact of the interest rate subsidy on new starts will be dramatically smaller than the 300,000 to 400,000. Something on the order of 50,000 to 100,000 at most is a more appropriate estimate.

The impact on the whole economy is even less, though, than the impact just on homebuilding. The program does not provide a cost less addition to mortgage credit. In fact, you can't provide a cost less addition to mortgage credit. It's got to come from somewhere. To the extent that there is an increase in need for a particular type of credit—in this case, mortgage credit—there's increased competition for funds in general. This increased competition will mean higher interest rates in general, unless the Federal Reserve works to dramatically ease monetary policy. Such a move to ease would have other effects that I don't think any of us want at the moment.

The net effect is that when looking at the macroeconomy, while there will be a boom in homebuilding, there will be some contraction in other sectors of the economy. As a result, the macroimpact is likely to be even smaller than the impact on homebuilding.

COST TO THE GOVERNMENT

My final point, getting to the cost to the Government, is that this is not a costless program. The interest rate subsidy is in essence an interest-free loan. The cost to the Government is appropriately measured as the cost of interest foregone. Assume that the Government can borrow at a rate of 13 percent and subsidizes an individual with a $65,000 loan who repays the loan in the 10th year. Assuming a marginal tax rate of 30 percent, that individual would get a subsidy that, in present value terms, would cost the Government $3,665.

If the total program authority were used, the total cost to the Government would depend upon marginal tax rates and when these loans were paid back. Averaging several possibilities, I estimate that cost to the Government would be somewhere in the order of $1.2 to $2 billion.

These cost estimates purposefully exclude any impact of increased economic activity on increased tax revenues. Any Government expenditure that puts people back to work will increase tax revenues. If we're going to distinguish between programs, we want to take out common factors and focus on particular costs.

I would just like to conclude with a few other concerns that I have, although these are concerns about which my training as an economist does not give me any special expertise. These concerns are closer to your expertise, Mr. Chairman. As a politician it is your job to look at questions of social conflict and help to resolve them.

In the present situation, we all want to get the economy back to work, but there's a question as to whether we do it by favoring particular special interests with a particular subsidy or whether we do it with a more general macrostimulative. At the same time, with a long run perspective, there are questions about productivity in the broader economy, capital formation, the rate of economic growth. Many argue that productivity and economic growth require more business investment. Historically, nominal tax laws with a high rate of inflation have tended to favor the housing sector. It is a very serious question as to whether we want additional special favor legislation to favor an industry that's already been favored quite substantially.

Senator **Lugar**. Thank you very much.

[Complete statement of Dr. Swan follows:]

Statement of Craig Swan, Department of Economics, University of Minnesota

The current status of the economy in general and the homebuilding industry in particular are of great concern. It is understandable that there is much interest in the interest rate subsidy program being discussed this morning. However, good intentions need not make for effective programs. Some statements made in support of the interest rate subsidy bill are clear exaggerations of what is most likely to occur should the bill become law. In particular, I have in mind statements that the bill will mean an additional 370,000 to 450,000 single-family housing starts, creating 791,500 jobs in a program that, due to increased tax revenues, will pay for itself. These statements appear to come from dividing proposed total spending by a estimate of the average mortgage loan; they exaggerate the impact of the proposed subsidy on the housing industry, the overall economy, and the federal budget.

IMPACT ON HOMEBUILDING

The impact of the subsidy on residential construction is more appropriately measured as the sum of three factors:

(1) How many marginal buyers are induced to enter the market for single-family homes because of the subsidy?

(2) How much more housing are intra-marginal buyers induced to purchase?

(3) How much less housing is demanded by non-subsidized buyers as a result of higher mortgage rates induced by the subsidy program?

It would not be surprising if the total authority for subsidized loans was used, but some buyers would have been in the market even in the absence of the subsidy program. It is simply inappropriate to include these families when measuring the impact of the program. The net impact on homebuilding comes from those families which otherwise would not have been in the market, what I have called the marginal families.

At the same time, the subsidy program is likely to induce intra-marginal subsidized buyers, those who would have been in the market anyway, to purchase a slightly larger home. This increase in demand, which depends upon the magnitude of the subsidy, will require more real resources—labor and construction materials—and should be included in a measure of the macro impact of the proposed subsidy.

Finally it is necessary to make a subtraction from the two items above to arrive at the net impact of the subsidy. In general, economists expect a subsidy that increases demand to increase prices as one moves along a market supply curve. In the case of housing there are two relevant supply curves. One is the supply of housing units, and the other is the supply of mortgage finance. At the present time, one might reasonably assume that the quantity of new housing units supplied can be increased without much if any pressure on wages and material prices, i.e. One might assume that currently the supply of new housing units is very elastic. However, the same cannot be said of the supply of housing finance.

The proposed subsidy helps borrowers meet mortgage payments, but it does not directly provide mortgage financing. The subsidy will enable subsidized borrowers to compete more effectively for mortgage finance. To the extent that the subsidy increases the total demand for mortgage financing, there will be pressure for mortgage interest rates to increase. The increase in mortgage interest rates is necessary to increase the supply of mortgage financing. This induced increase will tend to reduce the demand for mortgages and housing by nonsubsidized borrowers, just as the reduction in mortgage interest rates from the subsidy tends to induce an increased demand. The final net effect is still an increase in the demand for housing and mortgages, but it will be less than the net increase from subsidy recipients.

To estimate the net impact it is first useful to have an understanding of the economic impact of the subsidy program. The program calls for interest rate reductions for up to five years. The program also calls for borrowers to repay this subsidy at the time of sale or refinancing. The repayment matches the dollar amount of the subsidy without any adjustment for interest. Thus the program works like an interest-free loan contingent on buying a new home.

To measure the impact of this interest-free loan, I have calculated the effective after-tax mortgage rate for loans involving the subsidy. These calculations are reported in Tables I–IV. The calculations in the tables assume a single annual interest and principal payment at the end of each year. This assumption was made to simplify the calculations and has no essential impact on the conclusions. The impact of the interest free loan depends upon when the loan is repaid. The last column of each table shows the effective after-tax mortgage rate assuming that the subsidy is repaid in full for the year indicated. The dollar figures in the preceeding columns depend upon the initial loan balance, assumed to be $65,000. However, the calculation of the effective mortgage rate is independent of the size of individual loans. In all tables the net effect of the subsidy can be measured by comparing entries in the last column with the after-tax mortgage rate in the absence of the subsidy program, an amount shown at the top of each table.

In all tables the effective rate declines as one moves down the table, that is the subsidy offers the borrower a better deal the longer it is before the subsidy is repaid. Tables I and II refer to marginal tax rates of 30 and 20 percent, rates that are likely to be typical of single and married borrowers. Tables III and IV refer to the tax treatment of the subsidy repayment. In Tables I and II it is assumed that the subsidy repayment is tax deductible. In Tables III and IV it is assumed that repayments are not tax deductible. Note that in Tables III and IV, it is not before the fifth or seventh year that the effective rate with the subsidy is less that the after-tax rate without the subsidy. This result means that if the subsidy repayment is not tax deductible and if a potential home buyer anticipates moving before the fifth or seventh year, then he/she will actually be worse off with the subsidy than without. In these cases the interest saving at 15.5 percent is outweighed by the loss of tax deductions at marginal rates of 20 to 30 percent.

An important part of the impact of the proposed subsidy program will depend upon the difference between the effective subsidized rate and the non-subsidized rate. The subsidy is described as a four percent reduction in interest rates. However a look at Tables I to IV shows that it is more like a one to one-and-one-half percentage point reduction and thus similar to interest rate reductions offered by the Emergency Home Purchase Assistance Act of 1974 (EHPA).

The EHPA offered subsidies of one to two percent. The impact of the EHPA on housing starts was examined in a GAO study. The GAO used a group of consultants—Professors Dwight Jaffee, Patric Hendershott, Ken Rosen, George von Furstenberg, and myself. The consultants estimated that the EHPA program, involving subsidies on 190,000 loans, resulted in only 20,000 to 35,000 net new housing starts. If one applies this ratio to the proposed subsidy, the result would be about 40,000 to 70,000 net new housing starts.

The EHPA appears to have facilitated a substantial amount of inventory reduction. Currently inventories of unsold single-family homes are somewhat smaller than in 1974. As a result, the current proposal might have a marginally larger impact on new starts. I understand that the proposed legislation is aimed at new homes. The draft legislation that I have seen defines a new home as one completed after March 5, 1982. It would appear that this definition allows substantial room for inventory reduction.

The program may have an additional important impact to the extent that current high mortgage rates involve significant cash flow problems for borrowers. In an inflationary environment, high nominal interest rates impose significant cash flow burdens on borrowers in the early years of a mortgage. The proposed subsidy, in contrast to the EHPA subsidy, does involve a significant reduction in mortgage payments during the first few years of the loan. The theoretical impact of the cash flow burden from high nominal interest rates is well known. Its empirical importance is, however, less well documented.

The net result of all these consideration is that the proposed subsidy will result in a net increase in housing starts substantially less than 300,000 to 400,000 units. An estimate of the impact on total residential construction would need to include both the possibility of larger homes demanded by intra-marginal buyers and the "crowding-out" of non-subsidized buyers. It should also be noted that any increase in construction currently will come at the cost of less construction later. Individuals who are induced to buy a new home now will most likely not be looking for another new home soon. Looking over a longer period, perhaps three to five years, the proposed subsidy will have little if any impact on total housing starts. Its impact on construction activity will reflect the impact of the subsidy, shown in the tables as the difference between the effective subsidized mortgage rate and the unsubsidized rate.

IMPACT ON THE ECONOMY

Starting with the final net impact on homebuilding, the impact of the subsidy on total employment in the economy will be even less than its impact on construction employment. Increased demand by subsidized borrowers for mortgage credit will mean higher interest rates in general and a larger share of total financial flows in the form of mortgages. In the absence of increased homebuilding, most of these funds would have been available to finance other activity, for example business investment. Thus an estimate of the macro economic impact of the subsidy must take into account the negative impact of higher interest rates on other sectors of the economy. Note that this macroeconomic crowding-out would not be eliminated if, in addition to the interest subsidy, the federal government provided permanent mortgage financing. Any dollars for possible federal lending would have to come from increased federal borrowing.

COST TO THE GOVERNMENT

The cost to the government of the subsidy program will depend upon when homebuyers repay the subsidy. Given that the program works like an interest free loan, the cost to the government is appropriately measured as the interest on that loan. Using an interest rate of 13 percent, the present value of the interest subsidy on a $65,000 loan repaid in the tenth year is $3,665. If the full billion dollars of subsidy authority were used and all loans were repaid in the tenth year, then the total cost to the government of the subsidy program would be about $1.4 billion. If the subsidies were repaid in the fifteenth year the cost would rise to $1.9 billion.[1] If the subsidies were repaid in the eighth year the cost would fall to $1.1 billion. These cost figures are substantially higher than, but comparable to, those of the EHPA. The higher totals here reflect the combination of larger mortgages, more loans and higher interest rates.

These cost estimates purposely exclude any estimate of increased tax revenues from increased economic activity due to the subsidy. Note that the subsidy must be paid on all loans while increased tax revenues will come only from the net increase in economic activity, a number substantially smaller than that given by dividing total subsidy authority by an estimate of the average loan. Further, a program that increases investment in housing will mean less tax revenues to the extent that it increases homeowners' equity investments. Finally, any government expenditure will increase economic activity and increase tax revenues. The desirability of particular subsidy programs should be judged on their own unique benefits and costs.

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[1] Marginal tax rate 0.3 repayment tax deductible.

TABLE I.—EFFECTIVE MORTGAGE RATE WITH INTEREST SUBSIDY [1]

[Subsidy rate, 0.04 percent; mortgage amount, $65,000; initial maturity, 30 yrs.; mortgage rate, 0.155 percent; marginal tax rate, 0.2 percent; after-tax mortgage rate 0.124 percent]

Year	Mortgage payment	Mortgage balance	Subsidy repayment	Final payment	Effective interest rate
1	$7,610	$64,864	$2,600	$67,464	12.4
2	8,103	64,220	5,194	69,414	12.2
3	8,616	62,989	7,763	70,752	12.01
4	9,153	61,080	10,282	71,362	11.86
5	9,717	58,387	12,726	71,113	11.71
6	10,210	57,226	12,726	69,952	11.56
7	10,210	55,886	12,726	68,612	11.46
8	10,210	54,338	12,726	67,064	11.37
9	10,210	52,550	12,726	65,276	11.32
10	10,210	50,485	12,726	63,211	11.26
11	10,210	48,100	12,726	60,826	11.22
12	10,210	45,345	12,726	58,071	11.18
13	10,210	42,163	12,726	54,889	11.14
14	10,210	38,488	12,726	51,214	11.11
15	10,210	34,243	12,726	46,969	11.08
16	10,210	29,341	12,726	42,067	11.06
17	10,210	23,678	12,726	36,404	11.03
18	10,210	17,138	12,726	29,864	11
19	10,210	9,584	12,726	22,310	10.98
20	10,210	860	12,726	13,586	10.95
21	993	0	12,726	12,726	10.93
22	0	0	12,726	12,726	10.9
23	0	0	12,726	12,726	10.88
24	0	0	12,726	12,726	10.86
25	0	0	12,726	12,726	10.85
26	0	0	12,726	12,726	10.83
27	0	0	12,726	12,726	10.82
28	0	0	12,726	12,726	10.81
29	0	0	12,726	12,726	10.79
30	0	0	12,726	12,726	10.78

[1] Subsidy payment is tax deductible.

TABLE II.—EFFECTIVE MORTGAGE RATE WITH INTEREST SUBSIDY [1]

[Subsidy rate, 0.04 percent; mortgage amount, $65,000; initial maturity, 30 yrs.; mortgage rate, 0.155 percent; marginal tax rate, 0.3 percent; after-tax mortgage rate 0.1085]

YEAR	Mortgage payment	Mortgage balance	Subsidy repayment	Final payment	Effective interest rate
1	$7,610	$64,864	$2,600	$67,464	10.85
2	8,103	64,220	5,194	69,414	10.7
3	8,616	62,989	7,763	70,752	10.55
4	9,153	61,080	10,282	71,362	10.43
5	9,717	58,387	12,726	71,113	10.31
6	10,210	57,226	12,726	69,952	10.19
7	10,210	55,886	12,726	68,612	10.11
8	10,210	54,338	12,726	67,064	10.04
9	10,210	52,550	12,726	65,276	9.99
10	10,210	50,485	12,726	63,211	9.95
11	10,210	48,100	12,726	60,826	9.92
12	10,210	45,345	12,726	58,071	9.88
13	10,210	42,163	12,726	54,889	9.86
14	10,210	38,488	12,726	51,214	9.83
15	10,210	34,243	12,726	46,969	9.81
16	10,210	29,341	12,726	42,067	9.78
17	10,210	23,678	12,726	36,404	9.76
18	10,210	17,138	12,726	29,864	9.74
19	10,210	9,584	12,726	22,310	9.71
20	10,210	860	12,726	13,586	9.69

TABLE II.—EFFECTIVE MORTGAGE RATE WITH INTEREST SUBSIDY[1]—Continued

[Subsidy rate, 0.04 percent; mortgage amount, $65,000; initial maturity, 30 yrs.; mortgage rate, 0.155 percent; marginal tax rate, 0.3 percent; after-tax mortgage rate 0.1085]

YEAR	Mortgage payment	Mortgage balance	Subsidy repayment	Final payment	Effective interest rate
21	993	0	12,726	12,726	9.67
22	0	0	12,726	12,726	9.64
23	0	0	12,726	12,726	9.62
24	0	0	12,726	12,726	9.61
25	0	0	12,726	12,726	9.59
26	0	0	12,726	12,726	9.57
27	0	0	12,726	12,726	9.56
28	0	0	12,726	12,726	9.55
29	0	0	12,726	12,726	9.53
30	0	0	12,726	12,726	9.52

[1] Subsidy repayment [illegible] tax deductible.

TABLE III.—EFFECTIVE MORTGAGE RATE WITH INTEREST SUBSIDY[1]

[Subsidy rate, 0.4 percent; mortgage amount, $65,000; initial maturity, 30 yrs; mortgage rate, 0.155 percent; marignal tax rate, 0.2 percent; after-tax mortgage rate 0.124 percent]

year	Mortgage payment	Mortgage balance	Subsidy repayment	Final payment	Effective interest rate
1	$7,610	$64,864	$2,600	$67,464	13.15
2	8,103	64,220	5,194	69,414	12.95
3	8,616	62,989	7,763	70,752	12.7
4	9,153	61,080	10,282	71,362	12.5
5	9,717	58,387	12,726	71,113	12.3
6	10,210	57,226	12,726	69,952	12.03
7	10,210	55,886	12,726	68,612	11.83
8	10,210	54,338	12,726	67,064	11.69
9	10,210	52,550	12,726	65,276	11.58
10	10,210	50,485	12,726	63,211	11.49
11	10,210	48,100	12,726	60,826	11.41
12	10,210	45,345	12,726	58,071	11.35
13	10,210	42,163	12,726	54,889	11.3
14	10,210	38,488	12,726	51,214	11.25
15	10,210	34,243	12,726	46,969	11.2
16	10,210	29,341	12,726	42,067	11.16
17	10,210	23,678	12,726	36,404	11.12
18	10,210	17,138	12,726	29,864	11.09
19	10,210	9,584	12,726	22,310	11.05
20	10,210	860	12,726	13,586	11.02
21	993	0	12,726	12,726	10.99
22	0	0	12,726	12,726	10.96
23	0	0	12,726	12,726	10.93
24	0	0	12,726	12,726	10.91
25	0	0	12,726	12,726	10.88
26	0	0	12,726	12,726	10.86
27	0	0	12,726	12,726	10.85
28	0	0	12,726	12,726	10.84
29	0	0	12,726	12,726	10.82
30	0	0	12,726	12,726	10.81

[1] Subsidy repayment is not tax deductible.

TABLE IV.—EFFECTIVE MORTGAGE RATE WITH INTEREST SUBSIDY [1]

[Subsidy rate, 0.4 percent; mortgage amount, $65,000; initial maturity, 30 yrs; mortgage rate, 0.155 percent; marignal tax rate, 0.3 percent; after-tax mortgage rate 0.1085 percent]

year	Mortgage payment	Mortgage balance	Subsidy repayment	Final payment	Effective interest rate
1	$7,610	$64,864	$2,600	$67,464	11.97
2	8,103	64,220	5,194	69,414	11.82
3	8,616	62,989	7,763	70,752	11.62
4	9,153	61,080	10,282	71,362	11.42
5	9,717	58,387	12,726	71,113	11.22
6	10,210	57,226	12,726	69,952	10.92
7	10,210	55,886	12,726	68,612	10.7
8	10,210	54,338	12,726	67,064	10.54
9	10,210	52,550	12,726	65,276	10.41
10	10,210	50,485	12,726	63,211	10.31
11	10,210	48,100	12,726	60,826	10.23
12	10,210	45,345	12,726	58,071	10.16
13	10,210	42,163	12,726	54,889	10.1
14	10,210	38,488	12,726	51,214	10.05
15	10,210	34,243	12,726	46,969	10
16	10,210	29,341	12,726	42,067	9.95
17	10,210	23,678	12,726	36,404	9.91
18	10,210	17,138	12,726	29,864	9.88
19	10,210	9,584	12,726	22,310	9.84
20	10,210	860	12,726	13,586	9.81
21	993	0	12,726	12,726	9.77
22	0	0	12,726	12,726	9.74
23	0	0	12,726	12,726	9.71
24	0	0	12,726	12,726	9.69
25	0	0	12,726	12,726	9.66
26	0	0	12,726	12,726	9.64
27	0	0	12,726	12,726	9.62
28	0	0	12,726	12,726	9.6
29	0	0	12,726	12,726	9.59
30	0	0	12,726	12,726	9.57

[1] Subsidy repayment is not tax deductible.

Mr. ROSEN.

STATEMENT OF KEN ROSEN, CHAIRMAN, CENTER FOR REAL ESTATE AND URBAN ECONOMICS, UNIVERSITY OF SOUTHERN CALIFORNIA AT BERKELEY

Mr. ROSEN. Thank you, Senator Lugar. I have handed out copies of my testimony and I would like to summarize some of the statement.

First, I'd like to talk a minute about the housing problem and what has caused it because I think while we've heard some statements earlier I think people may have actually understated the problem. It's hard to believe that could be the case, but you'd have to study the numbers on a disaggregate basis—in other words, by region and type of unit—to see how serious the problem is and particularly in the single family sector.

If you look at the housing start numbers, it is the single family sector that's shown a very sharp decline from the previous levels. Single family starts in the latest months were about 550,000 and that is down almost two-thirds from their previous level. Existing home sales which are related to new single family starts are down to 1.8 million, which is down from a level of 4 million about a year and a half or 2 years ago.

So what we have seen is concentration of this problem in the single family sector. The rental sector and the multifamily is actually not doing as poorly.

Second, I think there is some anticipation of declining interest rates in the economy over the next six months, at least this is what all the forecasters say, and they expect to see some modest recovery in housing. I think this is a basically wrong expectation.

If you look at the disaggregate numbers, what we've seen is that the housing sector is not at bottom yet. If you look at California numbers, which often lead the country by about 2 to 3 months—if you look at the numbers carefully, what's happened in the last 3 months is the California housing market has completely collapsed. That is, the number of housing starts in California is down by almost 80 percent over where it was just a year and a half ago. So California, which almost always leads the country in terms of some of the price effects but also in some of the new construction effects if you look at past cycles, has shown a very significant decline in the last 3 months.

Overall, national housing starts have not moved very much in the last few months. They are at record depression lows but they haven't moved downward.

What these numbers indicate to me is, in the next 3 or 4 months, instead of going up, housing starts—especially, single family starts, will show further declines as we get bankruptcies in the building industry and a number of these sorts of things happening.

What I'd like to do now is highlight briefly what has caused the problem and why this program you have suggested in this bill will actually address the exact problem that is facing the housing industry.

INTEREST RATES AT RECORD HIGH LEVEL

If you turn to figure 3 in my prepared statement, you see what I think is causing the housing construction problem and housing purchase problem in 1982. The problem basically is that interest rates relative to inflation are at record high levels and the situation has gotten worse as our inflation performance basically has improved, but it demonstrates that interest rates have actually stayed about the same on the long side. So long-term interest rates relative to expected inflation are at record high levels relative to any period since World War II. There have only been two previous periods in our history where interest rates—that is real interest rates corrected for inflation—have been this high, and I hate to even use the word, but they were both during great depressions. They both preceded the Great Depression of the 1930's and the Great Depression of the 1870's. So the situation is not likely to improve in the housing sector until we get these real interest rates down, and I think that that really requires a combination of monetary and fiscal policy changes and that's very difficult to address here, but I think this bill in some sense is a way out of the monetary/fiscal policy box.

Let me now turn specifically to how I think this bill could be very successful. The program should be viewed—and I think as you talked in your statement—as temporary. What it is is a guarantee that we will have a recovery in housing. If the recovery occurs on its own because of declining interest rates, this program phases out. I think that's the essential interesting and very nice part of this program. The program will not need to come into effect if mortgage rates do decline substantially, as some forecasters think. The program will just phase out completely.

If interest rates do not decline, then the program will be in effect and will guarantee the recovery that everybody is hoping for. It will only be a modest recovery, but it will be some recovery in the housing sector.

I think the other thing worth talking about is the substitution effect. If you would like to turn to table 1A, I have done some estimates of the substitution effect; that is, how many units would be started anyway without the program and what the effects would be on the macroeconomy.

TOTALLY NEW PRODUCTION PROGRAM

Now I don't think you can compare this program to the 1974-75 program that was called the Brooke-Cranston bill for a number of reasons. First of all, no inventory qualifies under this program. Existing inventory does not qualify. So it's totally a new production program. I think that's very important. I argued in the 1974-75 period for that and people didn't listen too carefully and I argued against the same thing, inventory being included in the tax credit, and again they didn't listen. But I think this is very much earmarked for new production so it's a very different program.

Second, the state of the market is very different. Single family starts are at a much lower level than they were at that time period, at the 550,000 level, which is the lowest level in modern history—a much lower level. The overall start level is somewhat lower by about 200,000, but the single family sector is in much worse shape.

Third, I think the key to the success of this program is what I call the leverage. That is, for about $2,500 expenditure in the first year, you bring forth $65,000 roughly of private capital, so you have a very high multiplier, and that's what makes the housing sector different than any other sector of the economy, the use of this debt which leads to a high multiplier and a high impact in early years. That's what makes this program exciting and interesting and why it would work.

Also, it's worth mentioning that in 1974-75 we also had, in addition to the Brooke-Cranston, two other housing assistance programs to get us out of that recession. One was the tax credit of $2,000 for home purchase. The second was that the Federal Home Loan Bank put forth a number of subsidized or lower rate advances. So we had a lot of programs at that time to get us out of the housing recession. It didn't occur naturally through market forces, but there were some Government efforts. In every previous housing recession we've had some Government stimulus program.

Let me talk about the substitution effects directly. That is, how many units would likely be started anyway without this program? My guess is that with some decline in interest rates in 1982, there will be about 700,000 single family starts in the country. Now of those 700,000, half of them are more expensive than the mortgage ceiling limit in this program so they would not qualify for this program anyway. In addition, one-quarter of all houses are built by owners themselves. You may not believe that, but one-quarter of all single family housing are actually built by owners themselves and they also probably would not qualify for this program.

So the base you're starting from, the maximum amount of units that could be substituted for, that are being built by builders today, is at a very, very low level. I think that's what makes this program different than previous periods.

My calculation—and again, these are hard things to do as I think all of us would admit—is there are about 175,000 units that could possibly be substituted. So that's the maximum substitution effect from this program.

If you then say that these units will have to compete on a first-come-first-served basis with these new units that are going to be demanded coming on the market, my calculation is that approximately 120,000—as high as 126,000 units will actually be substituted under this program, which implies that the net start impact, depending on what price level you assume these houses will come in at, what mortgage ceiling, will be between 250,000 and 324,000, which is a very high multiplier on the numbers.

In terms of new job creation, that implies somewhere between 400,000 and 550,000 man-years of jobs—429,000 to 550,000 new jobs. And that uses the multiplier based on the Bureau of Labor Statistics of 1.7 man-years per house, which is a pretty standard number.

So making these assumptions, it looks to me the substitution effect will be, instead of being 75 percent which is roughly what Craig was talking about—and that's what was done in the Brooke-Cranston period—I would say the substitution will be more like 25 percent because it's a very different program and it's aimed at new production and has some price-income limits which are relatively strict compared to the previous program.

MACRO ECONOMIC IMPACT

Now I'd like to address briefly the macroimpact. I think this program will not make interest rates go up, but actually will make interest rates in the capital market go down. It sounds a little counterintuitive, but the basic box that the President's program is in is that high interest rates have made a very weak economy; a very weak economy has created high deficits, which in turn have created high interest rates, and both the Fed and the administration can't figure out how to get out of that box.

There's only one way out of that box. That's to get the economy growing again. What you want to do is pick a sector to stimulate that would have the maximum impact quickly to reduce the deficits and therefore reduce the expectation of higher deficits in the future which could lead to the increase in the supply of credit in the sense of a lower expectation of inflation in the future.

So a program like this, if it did reduce the deficits, which I think all the simulations of the macromodels show it will do, will basically, by putting people back to work—and it's true of any program, but this program is a more highly leveraged one—you get into a situation where interest rates will actually fall during the first stages of this recovery. It will not lead to crowding out. It will not require the Fed to monetize. Part of the reason I say that is that the markets are already expecting an increase in mortgage credit demand of about $30 billion. Everybody knows this will occur. Henry Kaufman has it in his projections and everybody has it in their projections. So I think this is not going to lead to any change in expectations and the $1 billion a year expenditure is so small relative to the size of the numbers you're talking about now that I don't think you would see that impact.

The second thing about the macroeconomic impact is the number I have here on jobs are only the direct impact effects. There's going to be a second and third round effect as you put people back to work in terms of materials supply companies such as lumber. Any macromodel will show that the net effects of any program, but especially a housing program, will be much larger than the initial effects. That's just a well-known multiplier. You may not believe the multipliers that are in some of the models which are as high as 2½ or 3, but the multiplier is there whether it's 1½ or 2. It's definitely a multiplier effect.

Now I do have some slight problems with the program and it mainly concerns the regional impacts and I'd like to just talk briefly about those.

First, I think you cannot have a uniform mortgage value and income limit across the country. It will lead to a lot of disparity and, being from California, I can tell you that virtually no California house will qualify under this program. We have a slight problem in California, as you are aware. And also very few in the Washington, D.C., metropolitan area will qualify. Also New York and Chicago.

What I would suggest in a spirit of New Federalism is that the limits on mortgage value and income be set by metropolitan areas so you can use basically some percentage of the median income and based on the numbers you have here, $30,000 nationally, that would be about 1½ times the median income in each metropolitan area. That would be consistent with the numbers you have in the bill. And 80 percent of the house value, the median house value, in each metropolitan area. Then you really would have a bill that would be exactly the same as the national bill but would allow the regional differentials to materialize. So it will help States that are high cost areas and be fair for both high and low cost areas.

The last constraint I have is on your allocation formula. I'm not sure anybody here actually simulated it, but I actually did to see what the impact would be by State and I have on my table 2 and table 3 the results. Unfortunately, the results of this allocation formula I think are going to lead to things you don't want to happen.

Some people from some States will like it to happen, but others won't, and table 3 really shows results in the third column.

Basically, because of the equal weighting of the three factors, it leads to much too much money to be allocated to very small States, such as Alaska, Delaware, and Montana. Montana gets 160 percent of its needs. Basically, there's too much money going to Montana relative to its average over the 1978–81 period. Much too little money goes to a State like Florida or California which have a higher amount of starts.

Now you can correct this quite easily in the formula—and I may have misread the formula—if you use absolute numbers rather than percentages. If you use absolute numbers, then the formula will produce results that are pretty reasonable.

Another alternative which I think is a better one to use but you certainly would have to make this decision yourself, is to take the percentage of housing activity in 1978 through 1981 and use that as your allocation formula, and that is shown in the last three columns—actually the next to the last column shows how much each State would get and that would lead to numbers that would be more in line with stimulating the housing industry rapidly. Possibly a weight of that number with the absolute number of unemployed people by State would produce the effect that you want to get at areas that have high unemployment but also affecting areas that really have normally had a lot of housing activity.

Under the other formula, what happens is that States such as New York and also very small States get more money than they are actually going to be able to use, so you may not want to do it that way.

If I could just summarize now, I think we are in a crisis obviously not only in the housing sector, but in the overall economy. In the housing sector it's clearly a depression. In the rest of the economy, despite the leading indicators and the numbers we've seen in the last couple months, I think is not going to recover unless we get a significant decline in interest rates. And the reason I strongly support this legislation is I think this is a way to drive a wedge in the circular causation problem that the administration and the Federal Reserve is in. It's a way of getting us moving again without changing any of the macroeconomic policy objectives they have and I think that is a policy that really might work very well. Also I think that lastly we have to realize we must provide some assistance in the housing sector at this point or it will not recover, and I think if it doesn't recover and we have a loss of capacity in terms of homebuilders, material suppliers, a whole range of people because of bankruptcies and failures, when we do get a recovery—and we will at some point because of the strong demographic demand—you might very well see a surge in house prices which would defeat much of the anti-inflation nature of the program that the administration is trying to put into effect.

So I think to lose the capacity at this point would be a serious mistake and I think anything that could be done to stimulate the housing sector would be very, very helpful.

[Complete statement follows:]

The Housing Depression of the 1980s

Federal Policy Mismanagement in an Era of Transition

Testimony of Professor Kenneth T. Rosen

Chairman, Center for Real Estate and Urban Economics
University of California at Berkeley

on

Senate Bill 2226 (Emergency Mortgage Interest Reduction Act)

before

Senate Subcommittee on Housing and Urban Affairs

March 23, 1982

The housing market in 1981 and early 1982 has been in a major depression approaching some of the worst activity levels experienced since the Great Depression of the 1930s (excluding the low levels of activity induced by war-time shortages in the 1940s). Housing starts dropped under 900,000 in the fourth quarter of 1981 and are not likely to rebound substantially in the near future, because of the deadly combination of high interest rates and a severe recession. Single family starts dropped to the lowest level in twenty years, 555,000. The sales of used homes also have fallen sharply to a level of 1.8 million units, less than half the sales rate of several years ago. Figure 1 and Figure 2 show these very sharp declines in activity level over the past several years. The only surprising fact illustrated by these charts is that, given the high interest rates now being experienced, there is any housing activity at all.

HOUSING TRENDS

SEASONALLY ADJUSTED ANNUAL RATES

FIGURE 1

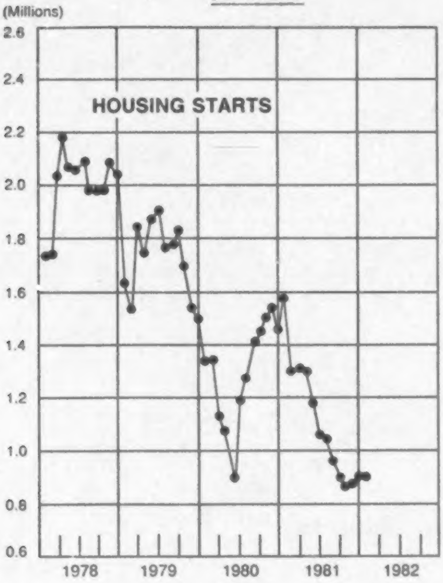
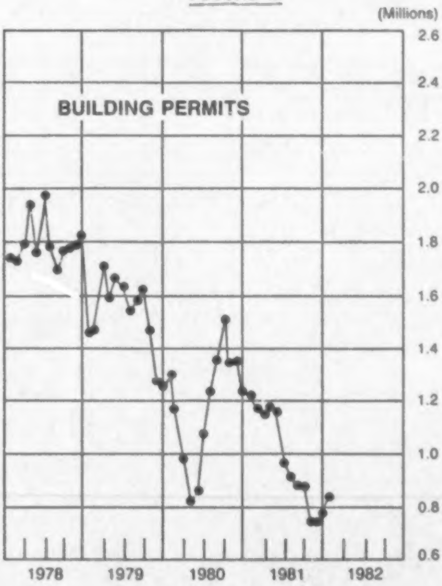


FIGURE 2



SOURCE: Bureau of the Census, U.S. Department of Commerce, NAHB Economics Division

Without a substantial change in economic policy which results in lower "real interest rates" we cannot expect a sustained recovery and there is a distinct possibility that even the remaining low levels of activity will collapse plunging the housing sector and the economy into an outright depression. It would be a depression created not by natural forces of a market, but rather by Federal policy mismanagement and its impact on financial markets. It is because of this pessimistic outlook that I strongly endorse Senate Bill (S2226) and its attempt to provide temporary countercyclical assistance to the housing sector. This assistance has a substantial chance to reverse the downward spiral in the housing sector and the overall economy.

Housing Demand in the 1980s

The sharp decline in housing production comes at a time when the "demographic demand" for housing is reaching record levels. The changing age distribution of the population, the overall growth of the population, and a small increase in household headship rates, will produce household formation demand for housing units in the 1.6 - 1.8 million per year range. Adding in even a very low replacement demand of 200,000 units per year, leads to production requirements of 1.8 - 2.0 million units per year just to avoid actual physical shortages of housing units.

The Reduction in the Housing Industry's Capacity

The prolonged depression in the home-building industry has affected the capacity of the homebuilders, materials suppliers, and others to respond to an upsurge in demand when it occurs. Home building and related industries are accustomed to cyclical fluctuations, but the current slump is unprecedented in modern history.

The cutback in capacity has occurred throughout the housing production system. Land development -- the lengthy process of assembling packages of land, obtaining approval to build, providing streets, water, sewage facilities, etc. -- has been cut way back. The stock of earth-moving machinery has deteriorated. Lumber mills have shut down and logging crews disbanded. Home builders have gone bankrupt in record numbers. The housing finance industry has had well-publicized difficulties and will soon have to deal with refinancing balloon-payment mortgages. Even the capacity of the title insurance industry could be a serious constraint if home sales were to return to the levels of three or four years ago.

It is difficult to underestimate the extent of these capacity reduction problems. They do suggest the possibility of a surge in home prices which could accompany a rapid improvement in demand. As a result, any effort to buoy the industry at this point could prevent an inflationary surge in house prices.

Federal Mismanagement of Monetary Policy

The major cause of the crisis facing the housing industry and the overall economy is the unprecedented interest rate and monetary instability of the past several years. The extreme volatility of interest and money supply growth rates in 1980, 1981, and early 1982 must be viewed as an unacceptable monetary policy. This sort of policy creates great uncertainty for households and firms and undermines the efficiency of any economy.

The major cause of this mismanagement of monetary policy revolves around the Federal Reserve's failure to anticipate or comprehend some of the key linkages between its activities and the financial and real sectors of the economy. The Fed appears to have erred in several fundamental ways. First, it seems to have forgotten that Fed policy works with a substantial lag -- and so appears to be reacting to current financial and economic conditions in a myopic way. This myopia has in part been accentuated by an underestimation of the market's response to exogenous economic stimuli and Fed activity. The Fed must anticipate and offset the market's overreaction to outside random shocks. While it must clearly focus on a long-run policy of slowing excessive growth of credit, it should not allow the violent short-term swings that might accompany its own release of statistically suspect weekly money supply members.

The second error in my view, concerns the perceived way in which monetary aggregates affect economic activity. Monetary policy does not work through a black box (in which monetary aggregates go in one side and inflation emerges at the other side), but rather through real and nominal interest rates. Real interest rates are the ultimate determinant of investment and economic activity. Nominal interest rates are also of major importance in certain sectors of the economy, such as housing. As a result, Fed policy has led to violent fluctuations in both the real and financial sectors of the economy in 1980, 1981, and early 1982. These fluctuations are themselves inflationary in that efficiency in the real sector is impaired, thus raising the cost of production. As a result, short-run, anti-inflationary, destabilizing actions of the Fed have actually contributed to long-run inflation.

While the Fed has been the prime cause of this instability and high level of interest rates, the large prospective Federal deficits have also contributed to the problem. Possible deficits of $100-200 billion per year for the foreseeable future are providing financial markets with an acute case of indigestion. A 40 to 50 percent increase in the national debt in three years is just plain unacceptable and cannot possibly be funded without a substantial resurgence of inflation. The potential massive deficits are not primarily caused by tax cuts but rather by an extraordinarily weak economy and continued runaway growth in the largest portion of the Federal budget, defense and social security expenditures.

This combination of monetary policy mismanagement and an unbalanced fiscal policy has created the highest real interest rates since World War II. As the Table and Figure that follow illustrate, real interest rates today are in the 5-8% range, far above anything experienced in modern history. Only in periods of deflation and depression have real interest rates been at such unprecedented levels. Only in the Great Depressions of the 1870s and the 1930s have real interest rates approached these levels. The housing depression is a consequence of these real rates. If these rates persist, it is likely that the overall economy will experience depression-like conditions.

Mortgage Interest Reduction Act: A Strategy for the Housing Crisis

Senate Bill 2226 in my view directly addresses a key problem facing the housing market -- high real and nominal mortgage interest rates. The main purpose of this proposal is to provide a temporary countercyclical assistance program to spur housing production and economic performance in 1982. It is basically a mortgage buy down program with the government providing a small amount of upfront money that could be leveraged 15 to 20 times by the private sector.

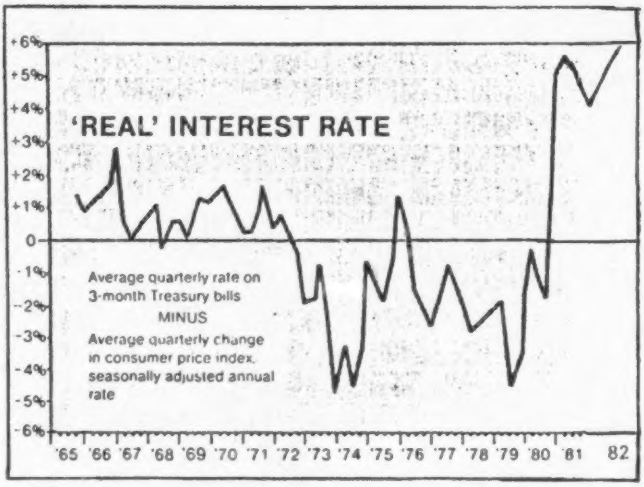
The program has as its central feature a reduction in mortgage rates to levels which are much below market rates and are somewhat more affordable for many households. At present market rates, the temporary mortgage reduction would reduce mortgage interest rates to approximately 13 %. This would reduce the before tax payment income ratio required by

Table 1

Real Rates of Interest Before Taxes

	Short-Term Real Rate	Long-Term Real Rate	% Change In CPI	4-6 Month Commercial Paper Rate	AAA Bond Rate
1951	-5.7	-3.4	7.9	2.2	2.6
1952	.1	- .7	2.1	2.3	2.9
1953	1.8	.8	.8	2.5	3.0
1954	1.1	.7	.5	1.6	3.2
1955	2.5	.7	- .4	2.2	2.9
1956	1.8	2.1	1.5	3.3	3.1
1957	.2	2.2	3.6	3.8	3.4
1958	- .3	2.3	2.7	2.5	3.9
1959	3.2	2.1	.8	4.0	3.8
1960	2.2	2.3	1.6	3.8	4.4
1961	2.0	2.5	1.0	3.0	4.4
1962	2.1	2.9	1.1	3.3	4.4
1963	2.3	3.2	1.2	3.6	4.3
1964	2.7	3.0	1.3	4.0	4.3
1965	2.7	3.1	1.7	4.4	4.4
1966	2.7	2.8	2.9	5.5	4.5
1967	2.2	3.1	2.7	5.1	5.1
1968	1.7	2.9	4.2	5.9	5.5
1969	2.5	2.8	5.4	7.8	6.2
1970	1.8	2.8	5.9	7.7	7.0
1971	.8	2.9	4.2	5.1	7.4
1972	1.4	2.6	3.3	4.7	7.2
1973	1.9	2.4	6.2	8.2	7.4
1974	-1.1	2.4	11.0	9.9	8.6
1975	-2.8	2.0	9.1	6.3	8.8
1976	- .4	1.3	5.7	5.4	8.4
1977	- .9	.3	6.5	5.6	8.0
1978	.3	.7	7.7	8.0	8.7
1979	- .3	1.6	11.3	10.9	9.6
1980	-1.2	2.9	13.5	12.3	11.9
1981	6.6	4.1	8.9	15.5	14.2

Figure 3



WALL STREET JOURNAL, Friday, October 2, 1981

Sources: Federal Reserve Board, Bureau of Labor Statistics the median income family to buy the median-priced house from 51 percent to 41 percent. On an after tax basis, this program would reduce payments from 39 percent of income to 33 percent of income. As a result, the reduction in interest rates would mitigate, but not solve the affordability problem.

The impact of the program on new housing starts and jobs in the construction industry is not as straightforward as some of the analysis you have received may indicate. The estimates of 370-450,000 starts and 791,000 jobs assume no substitution effects. It is quite likely that some number of these starts would have occurred even without this program. While the substitution effect is hard to estimate, the nature of the present housing crisis indicates that the substitution effect in 1982 would be relatively small. My base forecast shows that there would be 700,000 single family units started in 1981. Because of the mortgage and income limits set in this bill, roughly one half of the units would not be eligible for this program. In addition, nearly 25 percent of single family starts are self built. Thus, the maximum theoretical substitution effect would be 175,000 starts. However, these 175,000 units would be competing against the 450,000 additional units demanded because of the lower mortgage rate. Assuming the mortgages are allocated on a first come, first serve basis within a state, 72 percent of the maximum substitutable units would receive the subsidy. This would likely result in a substitution effect of 126,000 units. The same calculation on the 370,000 units produces a substitution effect of 118,000 units. Thus, the program would produce 252,000 to 324,000 housing units and 429,000 to 551,000 jobs. Table 1A highlights these results.

The effect on expected housing starts of this program are dramatic. Without the program, our base forecast was for 1.072 million housing starts in 1982 and 1.201 million starts in 1983. With the program, and assuming no substitution effects, starts would be in the 1.347 to 1.407 million range in 1982 and at the 1.3 million level in 1983. Even with the substitution effects, housing starts rise to the 1.269 to 1.324 million range in 1982 and to the 1.27 million range in 1983.

The major problems with the program revolve around the regional disparities which may be caused by the mortgage value limitation, the income limitation, and the state allocation formula included in the bill. Imposing a uniform mortgage value and income limitation across the country means that areas with high housing costs will be unable to take advantage of this program. In areas such as California, Washington, D.C., and many of the Western metropolitan areas, this program will not assist the housing market. As a result, I would strongly recommend that, in the spirit of the new federalism, the

Table 1A

Estimates of the Impact of SB 2226 on Housing Starts and Job Creation

	(1) No Substitution Effect Median Price $67,500	(2) No Substitution Effect FHA Price $55,500	(3) Substitution Effect $67,500	(4) Substitution Effect FHA Price $55,500
Dollar Subsidy per Unit	$2,700	$2,222	$2,700	$2,222
Number of Units for One Billion Dollars in 1982	370,000	450,000	370,000	450,000
Likely Substitution Effect	0	0	118,000*	126,000**
Net New Starts	370,000	450,000	252,000	324,000
New Net Jobs (1.7 man years plus starts)	629,000	791,000	429,000	551,000

* 175,000 units competing against 370,000 new units demanded on first come first serve basis would allow 67.8% of the substitutable units to be funded. (370/(370 + 175) = 67.8%)

** 175,000 units competing against 450,000 new units demanded would allow 72% of the substitutable units to be funded. (450/(175 + 450) = 72.0%)

Kenneth T. Rosen, University of California at Berkeley program limits on mortgage value and income be set by metropolitan area. The mortgage limit could be set at 80% of the value of the median-priced new home, and the income limit could be set at 150% of the metropolitan median. These numbers would be completely consistent with the national parameters now in the proposal.

The problem of the state allocation formula is much more complicated. In order to facilitate an analysis of the impact of the proposed formula and an alternative formula, I have done several simulations which are shown in the attached tables.

These tables show that there is a tremendous disparity in the three factors used for the allocation formula. The third column in Table 3 summarizes the essence of these results. The formula as proposed by the bill will fund only 5.5% of Florida starts, 6.4% of Texas activity, and 10.6% of California starts. On the other hand, it will provide too much money for small states such as Montana, Rhode Island, Delaware, and Alaska. In fact, it will fund more starts than are likely to occur in these states. Clearly, the formula needs to be revised. My suggestion is that a straight share weight based on the average of 1978-1981 starts be used. Columns (3), (4), and (5) in Table 3 show the outcome of such a scheme. Texas, Florida, and California here receive a much more reasonable share of the

Table 2

Allocation Factors

STATE	---POPULATION---		HOUSING STARTS		UNEMPLOYMENT		NET	
	FACTOR (1)	SHARE (2)	FACTOR (3)	SHARE (4)	FACTOR (5)	SHARE (6)	SHARE (7)	ALLOCATION (8)
ALABAMA	3,902	1.7	-56.0	2.3	12.5	2.8	2.3	23.1
ALASKA	404	0.2	-26.7	1.0	10.6	2.5	1.2	12.4
ARIZONA	2,737	1.2	-55.3	2.1	7.1	1.7	1.7	16.8
ARKANSAS	2,294	1.0	-56.1	2.2	10.2	2.4	1.9	18.7
CALIFORNIA	23,764	10.5	-58.0	2.3	9.0	2.1	5.0	49.9
COLORADO	2,905	1.3	-46.3	1.8	6.0	1.4	1.5	15.0
CONNECTICUT	3,111	1.4	-47.8	1.5	7.0	1.7	1.5	15.3
DELAWARE	596	0.3	-28.2	1.1	8.9	2.1	1.2	11.7
DIST OF COLUMBIA	635	0.3	-79.8	3.1	9.9	2.3	1.9	19.0
FLORIDA	9,792	4.3	-21.1	0.8	8.5	2.0	2.4	23.5
GEORGIA	5,461	2.4	-25.3	1.0	7.6	1.8	1.7	17.3
HAWAII	965	0.4	-48.2	1.9	6.1	1.4	1.2	12.3
IDAHO	951	0.4	-74.0	2.9	9.0	2.1	1.8	18.1
ILLINOIS	11,430	5.0	-78.7	3.1	9.4	2.2	3.4	34.3
INDIANA	5,490	2.4	-63.2	2.5	12.3	2.9	2.6	25.9
IOWA	2,918	1.3	-63.5	2.5	7.9	1.8	1.8	18.6
KANSAS	2,370	1.0	-43.5	1.7	4.9	1.2	1.3	13.0
KENTUCKY	3,673	1.6	-60.2	2.3	9.8	2.3	2.1	20.6
LOUISIANA	4,220	1.9	-37.1	1.4	9.3	2.2	1.8	18.4
MAINE	1,126	0.5	-45.7	1.8	7.4	1.7	1.3	13.4
MARYLAND	4,222	1.9	-37.7	1.5	8.7	2.1	1.8	18.0
MASSACHUSETTS	5,740	2.5	-25.0	1.0	7.6	1.8	1.8	17.7
MICHIGAN	9,271	4.1	-70.0	2.7	14.1	3.3	3.4	33.6
MINNESOTA	4,086	1.8	-52.2	2.0	6.4	1.5	1.8	17.8
MISSISSIPPI	2,527	1.1	-47.0	1.6	9.8	2.3	1.6	17.5
MISSOURI	4,926	2.2	-63.1	2.5	8.0	1.9	2.2	21.7
MONTANA	790	0.3	-77.5	3.0	7.1	1.7	1.7	16.8
NEBRASKA	1,573	0.7	-60.3	2.3	4.6	1.1	1.4	13.8
NEVADA	808	0.4	-59.2	2.3	6.3	2.0	1.5	15.4
NEW HAMPSHIRE	926	0.4	-35.4	1.4	5.4	1.3	1.0	10.2
NEW JERSEY	7,371	3.2	-39.4	1.5	7.7	1.6	2.1	21.0
NEW MEXICO	1,308	0.6	-48.8	1.8	7.8	1.8	1.4	14.4
NEW YORK	17,545	7.7	-35.5	1.4	8.1	1.9	3.7	36.8
NORTH CAROLINA	5,851	2.6	-37.1	1.4	7.0	1.6	1.9	18.6
NORTH DAKOTA	654	0.3	-64.3	2.5	5.2	1.2	1.3	13.4
OHIO	10,806	4.8	-33.6	2.5	12.2	2.8	3.4	33.7
OKLAHOMA	3,038	1.3	-35.7	1.4	4.1	1.0	1.2	12.4
OREGON	2,650	1.2	-66.8	2.6	12.0	2.6	2.1	21.0
PENNSYLVANIA	11,872	5.2	-52.2	2.0	9.9	2.3	3.2	32.0
RHODE ISLAND	947	0.4	-49.5	1.9	7.7	1.8	1.4	13.8
SOUTH CAROLINA	3,130	1.4	-45.1	1.8	9.9	2.3	1.8	18.3
SOUTH DAKOTA	691	0.3	-55.5	2.3	5.4	1.3	1.3	13.1
TENNESSEE	4,607	2.0	-56.5	2.2	10.6	2.5	2.2	22.3
TEXAS	14,314	6.3	-26.1	1.0	5.5	1.3	2.9	28.7
UTAH	1,473	0.6	-70.0	2.7	7.4	1.7	1.7	16.7
VERMONT	513	0.2	-4.7	0.2	5.9	1.4	0.6	6.0
VIRGINIA	5,365	2.4	-42.5	1.7	6.7	1.6	1.9	18.9
WASHINGTON	4,157	1.8	-61.5	2.4	11.4	2.7	2.3	23.1
WEST VIRGINIA	1,958	0.9	-51.3	2.0	10.5	2.5	1.8	17.8
WISCONSIN	4,717	2.1	-67.1	2.6	9.1	2.2	2.3	22.9
WYOMING	476	0.2	-46.4	1.9	4.6	1.1	1.1	10.8

NOTES:
(1) Total resident population, July 1980
(2) Percentage of total U.S. resident population
(3) Percentage change in private single family and 2-4 unit multifamily housing starts, 1978 to 1981
(4) Share computed by totalling Column (3) entries
(5) Average unemployment rate Oct.-Dec. 1981. Individual state unemployment rates seasonally adjusted by U.S. seasonal factor
(6) Share computed by totalling column (5) entries.
(7) Average of Columns (2),(4), and (6)
(8) Allocation based on $1.0 billion and share in Column (7) ($millions)

Source: Regional Data Associates

TABLE 3

Allocation Factors Impact
- - Existing Formula and Alternative - -

STATE	ALLOCATION	IMPLIED STARTS	PCT 78-81 STARTS	AVG 78-81 STARTS	SHARE 78-81 STARTS	IMPLIED ALLOCATION
ALABAMA	23.1	8.5	25.4	28.1	1.9	18.6
ALASKA	12.4	4.6	116.1	4.0	0.3	2.6
ARIZONA	16.8	6.2	13.8	45.0	2.9	29.3
ARKANSAS	18.7	6.9	42.4	16.3	1.1	10.6
CALIFORNIA	49.5	18.3	10.6	173.1	11.3	112.7
COLORADO	15.0	5.5	15.7	35.3	2.3	23.0
CONNECTICUT	16.3	6.0	49.7	12.1	0.8	7.6
DELAWARE	11.7	4.3	154.1	2.8	0.2	1.8
DIST OF COLUMBIA	19.0	7.0	391.8	1.8	0.1	1.2
FLORIDA	23.8	8.8	5.5	159.7	10.4	104.0
GEORGIA	17.3	6.4	14.0	45.8	3.0	29.8
HAWAII	12.6	4.7	53.5	8.7	0.6	5.7
IDAHO	18.1	6.7	86.6	7.6	0.5	4.6
ILLINOIS	34.4	12.7	30.4	41.9	2.7	27.3
INDIANA	25.9	9.6	34.8	27.9	1.6	16.0
IOWA	18.8	7.0	51.4	13.5	0.9	8.6
KANSAS	13.0	4.8	30.5	15.7	1.0	10.3
KENTUCKY	20.6	7.7	32.8	23.6	1.5	15.4
LOUISIANA	18.4	6.8	23.8	28.6	1.8	18.7
MAINE	13.4	5.0	93.2	5.3	0.3	3.5
MARYLAND	18.0	6.7	28.0	23.8	1.5	15.5
MASSACHUSETTS	17.7	6.5	36.0	18.2	1.2	11.8
MICHIGAN	33.6	12.5	30.8	40.6	2.6	26.5
MINNESOTA	17.8	6.5	20.7	31.9	2.1	20.7
MISSISSIPPI	17.6	6.5	44.1	14.8	1.0	[illegible]
MISSOURI	21.7	8.0	25.2	31.9	2.1	20.[illegible]
MONTANA	16.9	6.2	160.1	3.8	0.3	2.[illegible]
NEBRASKA	13.6	5.2	57.6	9.0	0.6	5.[illegible]
NEVADA	15.4	5.7	34.5	16.6	1.1	10.[illegible]
NEW HAMPSHIRE	10.2	3.8	56.9	6.7	0.4	4.3
NEW JERSEY	22.0	8.2	26.1	29.1	1.9	18.8
NEW MEXICO	14.4	5.3	48.2	11.1	0.7	7.2
NEW YORK	36.8	13.6	41.6	32.8	2.1	21.3
NORTH CAROLINA	18.9	7.0	16.0	43.8	2.9	29.5
NORTH DAKOTA	13.4	4.8	91.3	5.4	0.4	3.5
OHIO	33.7	12.5	26.1	47.6	3.1	31.2
OKLAHOMA	12.4	4.6	15.1	30.3	2.0	19.7
OREGON	22.0	8.1	33.0	24.7	1.6	16.1
PENNSYLVANIA	32.0	11.9	27.6	43.0	2.8	28.0
RHODE ISLAND	13.9	5.2	128.1	4.0	0.3	2.6
SOUTH CAROLINA	18.3	6.8	27.6	24.5	1.6	16.0
SOUTH DAKOTA	13.0	4.8	95.1	5.1	0.3	3.3
TENNESSEE	22.5	8.3	25.5	32.6	2.1	21.2
TEXAS	26.7	10.6	6.4	167.4	10.9	109.0
UTAH	17.1	6.3	45.5	13.9	0.9	9.1
VERMONT	6.0	2.2	55.9	4.0	0.3	2.6
VIRGINIA	16.6	6.9	16.7	41.3	2.7	26.9
WASHINGTON	23.1	6.5	20.5	41.6	2.7	27.1
WEST VIRGINIA	17.6	6.6	85.1	7.6	0.5	5.0
WISCONSIN	22.6	8.4	33.2	25.4	1.7	16.6
WYOMING	10.6	3.9	79.2	5.0	0.3	3.2

Source: Regional Data Associates

interest reduction funds.

In summary, the housing industry and the overall economy is in a state of crisis approaching depression conditions. The temporary mortgage interest rate reduction proposed in this bill will not solve the problem but will help moderate the crisis. I strongly support this proposed legislation. In addition, the Federal Reserve Board must pursue a more moderate "real interest rate policy" during the transition period. The failure to adhere to a real interest rate policy target is completely indefensible given the crisis it is producing throughout the economy. The Fed should abandon black box monetarism and pursue a "real interest rate" policy. Utilizing monetary aggregate targets in a period when the financial structure is changing so dramatically must be perceived as a major error.

Finally, policymakers must recognize the importance of stabilizing housing production if the inflationary spiral in housing costs is to be contained in the long-run. Adequate and affordable housing for the maturing post-World War II baby boom generation is essential if we are to meet our obligations to the present generation. Homeownership is a critical building block for our democratic system. Ignoring the shelter (rather than investment) demand for owner-occupied housing in the 1980s will create a major political and economic crisis.

Senator LUGAR. Thank you very much, Mr. Rosen.

It's a pleasure to greet Pat Hendershott, recently at Purdue University where we've worked together on some occasions, now at Ohio State University. Please proceed with your testimony.

STATEMENT OF PATRIC HENDERSHOTT, PROFESSOR OF ECONOMICS, OHIO STATE UNIVERSITY

Mr. HENDERSHOTT. Mr. Chairman, I'm pleased to have an opportunity to assess and hopefully assist in shaping this legislation. I'm especially pleased to speak with you on the eve of Purdue's battle for the National Invitational Tournament championship.

The combination of high real and nominal interest rates and declining real incomes has brought housing production to a near standstill. Nonetheless, an even sharper decline in household formations has created an excess supply of housing units. This supply is now concentrated in the area of vacant existing homes. Builder inventories have been cut back sharply, although they are still a little high relative to the snail-like pace of sales, and the rental vacancy rate has not risen throughout this period of stagnant housing activity. By historic standards, there are 200,000 to 250,000 more vacant existing homes for sale than is normal. As a result, existing house prices are under substantial downward pressure.

There has been a vague recognition that the reindustrialization and redefense of the United States would require or lead to some reduction in housing production from the levels of the later 1970s and that the transition to the lower level of activity might be difficult. But virtually no one envisioned the disaster of the last year. The premise of the proposed legislation is that real and nominal interest rates will eventually come down and that real income growth will resume along a sharp upward path. At such a time, rapid household formation will resume and the demand for housing units will accelerate along with other demands, creating potential inflationary pressures.

I want to emphasize this assumption and its importance to the assessment of the wisdom of the proposed legislation. If the assumption is not correct, then building more houses would, of course, be nonsensical; it would only add to an excess supply. While I would caution against the naive extrapolation of past household formation rates into the future and reemphasize that reindustrialization and redefense will require a temporary reduction in consumption, including that of housing services, the assumption of growing housing demand in the 1980's is plausible. This is especially true given the length and depth of the current housing retrenchment.

In general, I consider "bailout" legislation for particular industries to be quite inappropriate. For one thing, the number of sectors or segments of the economy undergoing substantial stress is large: airlines, autos, and on through the alphabet. I am sure that your constituents are keeping you well informed on this score. A general bailout would be extremely costly. For another, many attribute the high-inflation, stagnant economy of much of the last decade in no small part to a major expansion of federal assistance programs in numerous areas. A major component of Reaganomics is a general reduction in such federal programs, introduction of a new program, especially by those who purport to support this particular component of Reaganomics, appears, at least at first blush, incongruous. Housing and the economy generally would benefit far more from evidence of a positive full-employment surplus in, say, 1987, than any bailout I can imagine.

PROPOSED CHANGES IN LEGISLATION

The question then, is what, if anything, can be done to turn around the economy in the housing industry without undermining the basic thrust of the economic recovery program. I would suggest that with a few small changes the proposed legislation could make a positive net contribution. Two of the changes are requiring: 1) that the subsidized mortgage involve a dwelling started, rather than completed, on or after March 6, 1982 and 2) that the mortgage commitment be drawn down no later than March 6, 1983. In the remainder of my discussion I will assume that these changes have been made.

The goal of the legislation is simple: Provide the economy with a temporary quick boost at a relatively low cost. The low cost has two aspects; useful, lasting goods of value should be produced and the cost to the taxpayer should be minimized. The legislation would accomplish this goal by (1) encouraging, for a short period only, the construction of single-family housing, goods with a short production period and lasting value (as long as one accepts the high future-demand assumption), (2) restricting the subsidy to new starts, as opposed to newly-built homes in inventories or existing houses, and (3) requiring a payback of the subsidy. Note that the legislation does not include bailouts for existing losers in the housing area, of which there are many. This is a forward-looking economic stimulus proposal, not a backward-looking bailout. Furthermore, in what must be a rarity in legislative proposals, the true cost to the taxpayers is, I think, substantially overstated. Assuming that the program is fully utilized, I compute the cost to be a $2 billion, not $5 billion. I will return to this point below.

Having stated my general support for the modified legislation, I now turn to some specific issues. My remaining remarks are divided into four parts: (1) a general characterization of the proposal and the mechanism through which it will stimulate housing demand, (2) a statement of my view that the program as structured will be underutilized, i.e., a significant part of the funds allocated will go unused, and thus that the stimulus to starts will be less than envisioned, (3) suggestions to improve the utilization of the program without increasing the subsidy per start, and (4) suggestions to improve the equity of the program without raising its total cost.

CHARACTERIZATION OF THE PROGRAM

The subsidy is really an interest-free loan; interest is paid late (recaptured), rather than on schedule. Thus, the program is analogous to accelerated depreciation for business. It is a decelerated cost payment system rather than an accelerated cost recovery system. Of course, interest-free loans are valuable to borrowers and costly to lenders, especially when market interest rates are high. Thus, there is a clear subsidy—I calculate it to be equivalent to a five percent reduction in the price of the house being purchased. That's an average. As Professor Swan pointed out, the reduction will vary by household income and holding period. But ignoring the recapture overstates the true subsidy by a factor of two.

The subsidy does something else that is important to housing demand—it converts a level-payment mortgage into a quasi-graduated-payment mortgage; payments rise for five years and are then level until the balloon payment (recapture) upon sale or refinancing. With nominal interest rates at current levels, some households with limited wealth cannot afford the initial payments on the house that the underlying economic calculation tells them is optimal. The payments will be affordable in the future as the household's income rises with the price level. The problem is that the level mortgage payment stream does not match the rising income stream of the household. The payment stream generated in this legislation is more appropriate, although one might be concerned that the 5.5-percent graduation rate is higher than households desire in this era of declining inflation and thus nominal income growth rates. This is especially true if, as one might expect, builders will lower initial monthly payments further via buydowns, thereby creating an even higher graduation rate.

Thus, the program raises the underlying demand for housing by lowering the true house price and allows households to make this demand effective by tilting the payments. This tilt could also raise the housing demand of households whose demand existed even without the subsidy, but who could not afford the high initial payments and thus whose demand was not effective. One should note that this demand could be stimulated without a subsidy but with expanded usage of graduated payment mortgages.

UTILIZATION OF THE PROGRAM AND STIMULUS TO STARTS

If housing markets were in full equilibrium, then one would expect numerous renters to attempt to become owners of new houses and many owners of existing houses to desire to purchase new houses. An excess demand for subsidized loans would exist. To the extent that the loans were supplied and household demands became effective, vacancy rates for both owner-occupied and rental housing would rise. The rise would be reversed in the future when lower interest rates and more rapid income growth triggered an increase in household formation.

The demand for subsidized loans will be substantially limited by current conditions in the housing markets and particular restrictions contained in the proposed legislation. First, the sharp run up in real and nominal interest rates has raised the economic cost of owner-occupied housing substantially vis-a-vis the cost of rental housing. There are few renting households near the margin of shifting to owning. Even with the subsidy this program offers new owner-occupants, there will not be a large desired shift from rental to owner-occupied housing. Second, the housing market is severely depressed in a number of areas of the country. As a result, the price of existing housing is more than 5 percent below its replacement cost. Even with a 5 percent subsidy to new starts, existing housing is cheaper. The State allocation formula based heavily on unemployment, both overall and in the housing construction trades (decline in starts since 1978) virtually guarantees that there will be a substantial excess supply of subsidized loans in depressed areas. Third, many current homeowners have existing mortgages at rates two- and three-percentage points below the 11.5 percent subsidized rate. Many of these households will not find the subsidized loans superior to their present below-market rates. While the effect of these influences is difficult to assess, I would be surprised if the legislation generated more than 100,000 starts in the 1982 building season above what would occur in the absence of the program. Of course, lower utilization would lower the federal cost below that budgeted. Moreover, if the wording of the legislation only restricts the subsidy to mortgages financing completions, rather than to those financing starts and does not require a draw down of the mortgage commitment by March 1983, then the stimulus to 1982 starts will probably be cut in half.

IMPROVEMENTS IN UTILIZATION

Insofar as one believes the motivation underlying the proposed legislation, changes in the legislation that would improve its utilization without raising the subsidy per unit would seem desirable. Two changes merit consideration. First, the allocation mechanism should be less restrictive. Possibly States could lose part of their allocation if 50 percent of it were not committed within 4 months. I might also note the questionable wisdom of heavily subsidizing construction in areas where a large excess supply of housing already exists. Second, the graduated equity mortgage could be jettisoned and replaced by a more gradually accelerated-payment plan. To illustrate, payments could rise at only two-thirds the rate in the proposed legislation to the same eventual level at the end of the 8 year if no equity accumulation were forced without increasing the subsidy per unit. Households would almost certainly find this more appealing. A third mechanism to increase utilization would be to raise the income and mortgage ceilings. This would, however, raise the subsidy per unit.

IMPROVEMENTS IN EQUITY

Rental housing subsidies have been roundly and justifiably criticized for their gross inequities. More households have qualified for subsidies than there are available subsidized units; some get the subsidy and some don't. Moreover, those receiving the subsidies can be less qualified (have higher incomes) than those not receiving the subsidy. Finally, some subsidized households live in far superior housing than nonqualifying households that pay taxes to finance the subsidies.

Many of these criticisms can be levied at the proposed program. A household earning $30,000 can obtain a subsidy worth $3,400 (.05 times $67,500), while a household earning $30,001 qualifies for nothing. Much worse, a household earning, say, $20,000 might qualify and desire the subsidized loan but still be left out in the cold.

A minimally acceptable subsidy program from an equity viewpoint would seem to require that no household with income lower than a household being subsidized be prevented from receiving the subsidy. The simplest way of meeting this standard is to make the subsidy available to all who qualify. In my view, this could be achieved without raising the budgeted outlays by simply removing the State allocations and changing a half-point, commitment fee. That is, I do not think the subsidized loans would be oversubscribed even without the allocation formula. If you disagree with this assessment, then you should reduce the subsidy per unit sufficiently to lower the effective demand for the subsidy down to your desired supply. I really don't see why a household earning $30,000 in, say, Kokomo is more worthy of Federal largesse than is a household earning $20,000 in, say, West Lafayette.

CONCLUSIONS

Let me close by summarizing my recommended changes in the legislation in order of their importance:

First, require that the subsidized mortgage involve a dwelling started, rather than completed, on or after March 6, 1982. Subsidizing near completions is a bailout that will do little to encourage starts.

Second, require that the subsidized mortgage be taken down prior to March 6, 1983 and that a commitment fee be paid to discourage frivilous applications. The legislation should stimulate housing and economic activity in 1982, not 1983.

Third, the allocation formula should be modified or, better yet, deleted altogether. The formula encourages construction in areas where the housing market is overbuilt, virtually guarantees underutilization of the program, and creates great inequities.

Fourth, the GEM should be replaced by a pure GPM with a less rapidly rising graduation rate. This would have more appeal to households and would thus have a more stimulative impact.

I view the legislation as a serious effort to stimulate economic activity without either opening up the Federal Treasury to a virtually unlimited demand for bailouts or undermining the basic thrust of the economic recovery program. With the modifications I have proposed, I think this legislative effort will be successful.

Let me close by addressing Senator Proxmire's question on crowding out due to greater credit demands.

Consider two alternative interest rate scenarios in the absence of the passage of this bill.

(1) Interest rates will rise or stay constant throughout the summer of 1982. In this case, don't pass this bill. Get out campaigning for your friends if you're not up for reelection yourself. Elected officials will be in enormous trouble.

The second scenario is that interest rates will decline. If interest rates do decline soon, then the bill becomes irrelevant. If interest rates decline later, the 1982 building season will be missed. What this act does is guarantee that we will not miss the 1982 building season.

Senator LUGAR. Thank you very much, Dr. Hendershott, for sobering political advice in this housing testimony.

There are two areas of inquiry I would like to pursue with the panel. You have been most informative in terms of suggestions as to the feasibility of how rapidly housing starts might occur and whether the program would be utilized. It seems the general feeling of the panel is that we would not have to worry about 400,000 families battering down the doors to use the program.

Dr. Hendershott, you suggested there is no probability of that and that if we thought there was, then we ought to reduce the subsidies substantially enough to get everybody in. But is this a general feeling that 400,000 people are not out there presently that would use the program?

Mr. **Rosen**. I would say that interest rates that are contemplated on the FHA look like it will be somewhere about 12 or 13 percent, conventional market about the same. That's a very good interest rate and there are a lot of people out there and we have had deferred demand for 2 or 3 years here. So I think you're going to need an allocation formula.

EXCESS DEMAND

I think the number will be approximately 400,000 to 600,000 using the model I have that would want this at that interest rate. So it's a tough question, but I think there probably will be slightly excess demand. We don't know how much and it will be very different regionally. In some areas that are very depressed where we have an oversupply it would be less of a problem, but there are a number of areas where you don't have an oversupply. So I think you're still going to need some allocation formula.

Senator **Lugar**. Dr. Swan, do you have any feeling as to what kind of demand there will be for this program, leaving aside the substitution effect you addressed, how many applicants are we likely to see?

Mr. **Swan**. I don't have a particular numerical estimate, but it wouldn't surprise me if a lot of the authority were used, separate from questions of allocation. As Professor Rosen suggested, the subsidy does offer a good deal to buyers. That's why I want to distinguish between number of net new start—a number that varyies from 50 to 200 thousand, depending upon who you listen to here—and the number of subsidized loans that are likely to be made. Even without the subsidy there is likely to be a large number of people in the market. Without the subsidy they will buy smaller homes or scrimp in other ways to buy the home that they originally wanted. The interest rate subsidy will pay subsidies to these people, but it is inappropriate to count them as additional starts.

Senator **Lugar**. Each of you have participated, as Dr. Swan pointed out, on the evaluation of the Brooke-Cranston program before, and therefore are knowledgeable about these sorts of programs.

EFFECT ON EMPLOYMENT

Just for the record, in your judgment, can a new multifamily program have an effect on employment in this country within the next 8 months, a new multifamily program as opposed to the situation we're talking about today?

Mr. **Rosen**. I think the lag time is much longer.

Senator **Lugar**. What would the lag time be, in your judgment?

Mr. **Rosen**. Certainly even 3 or 4 months to get the permits and everything, so I think multifamily isn't as quick timing-wise, plus the construction period is between 9 and 12 months. Construction on the single-family home averages 4.8 months. So it isn't as feasible to get a quick stimulus from that program, even though I would not oppose a program for multifamily, but if you want it quickly I think the single family is more reasonable.

Senator **Lugar**. Do either of you have a substantially different judgment than that?

Mr. **Hendershott**. No.

Mr. **Swan**. No.

Senator **Lugar**. So the panel would be unanimous if we were seriously thinking about homebuilding activities of this calendar year or this building season, then we have to look at a program of not the type that's embodied in the legislation before us but something that's a reasonable facsimile. Is that generally true, if there is to be an employment stimulus and activity, that happens in this calendar year?

Mr. **Rosen**. Yes, and I think it's also worth saying that in the multifamily sector you're producing about 400,000 units a year already, so it hasn't had the same sharp decline as the single-family housing. It's a very different cycle. It's the first time this has happened in the post World War II period.

Mr. **Hendershott**. I'd just like to say that I think the potential problem is that the current legislation won't have an impact in this building season either and, of course, if it won't have much of an impact, the multifamily is just out of the question. There is a problem, if there is no commitment fee to apply for these subsidized mortgages, that there will be enormous demand for them simply because they are a free good. Builders who are not geared up and are not really prepared to start any time soon would be glad to try and latch onto these. So I think it's important: (a) to charge a commitment fee so there are not frivilous applications and, (b) to require that the commitment be drawn down before some date that would insure its utilization in the current building season.

Senator **Lugar**. To that end, apparently the bill tries to address it by saying October 31 of this year is the cutoff time.

Mr. **Hendershott**. The bill says, as I read it, that somebody has to apply for the commitment by then, not that the mortgage has to be taken out at that time. There would be many homes that you would want to stimulate that would not be completed by November 1 and if the mortgage is associated with the completion of the home I think that date is too restrictive.

On the other hand, if that's a commitment date, then the mortgage could be taken down many, many months later and it could spill over into the next building season very easily.

Senator **Lugar**. I think the point is well taken and that's valuable testimony today as to how to craft the language. I think we've used sort of the section 235 firm commitment ideas. It's a fairly well-tested concept with regard to that. That may not be sufficient. And since obviously the point is new starts and early commitments draw down then it could very well be that the date needs to be fixed in a different way to bring that stimulus.

Dr. Rosen has suggested that the current economic policies of the current administration and Congress have led to a box of sorts in which there appears to be very little way out without there being some causative factor to get us out of the box. This bill may or may not succeed in doing that.

One reason for introducing it is the feeling that it would, without having some break in this real interest rate situation so that some new income comes into the Treasury, the decline in the deficit is perceived and therefore a different confidence level occurs and/or some things change with regard to the Federal budget struggle vis-a-vis the Congress and the President. There are some heavy items involved here, but this is what the bill is all about and, as we pointed out to begin with, it could have occurred in any other committee. It happens to come here with the assumption that this is a pathway conceivably out of the box and that we can come into some additional income and some lower interest rates due to the confidence factor which lowers the so-called real interest rate which many of us feel is abnormally high, given any history of the economy.

What is the feeling of the panel generally? Mr. Rosen has addressed himself to this, that this may be a way out of the box. Do either of the other two of you have a feeling on that subject?

Mr. **Hendershott**. I don't really think this legislation provides a way out of the box. First of all, I don't view the 1982 deficit as being anything to worry about, and I wish people wouldn't continually emphasize it. In fact if you do pass a program it would be ideal if you can frontload it. The problem to the financial markets is the projected deficits in 1984, 1985, and 1986 and on forever. That's the box. The premise of this bill is that come October 1 the box will have been escaped by compromise between the various branches of the Government that substantially reduces the outyear deficits in a reasonable manner. What this bill does is save the summer of 1982. If we wait until October 1 we have gone through another period of substantially underutilized resources in the construction industry and elsewhere. I think the bill should be viewed as trying to save the summer of 1982. Exiting the box will take a lot tougher actions than passing this legislation.

Mr. **Swan**. I am more sympathetic with Professor Hendershott's position than Professor Rosen's. The confidence factor you referred to I would call a concern about future deficits. One starts with the very stimulative fiscal pressures from scheduled tax reductions passed last year. When you combine that with the very tight monetary policy that we're currently experiencing, the result is just very high interest rates. Then any proposal, this proposal or any other proposal, that commits the Federal Government to expenditures is only going to add to the magnitude of the deficit. To the extent there's an increase in economic activity, there will be some induced revenue, but again, that's true for all programs, not just this program. I think that the way out of the box is to change the mix between fiscal and monetary policy, to have slightly more restrictive fiscal policy and slightly more expansionary monetary policy.

Senator LUGAR. Each of you has testified, as we asked you to, on the basis of competence in the economic sciences, and you have offered a number of contributions. One of the things you've touched upon, particularly Mr. Hendershott, is the feasibility of considering such a proposal at all.

ADMINISTRATION'S VIEW OF PROPOSED BILL

Let me just touch upon that briefly and ask for your comments maybe as citizens, as generalists, as political scientists, in addition to being economists. Presently, as I visit with members of the administration, their feelings are summed up this way: Congress is visiting with them every day about reducing the deficit. Dr. Hendershott has said this should not be as great a concern to Congress and the administration, but it is. Every day conferences are held at the White House trying to determine how Federal spending can be reduced in this coming fiscal year as well as the out-years of 1984, 1985, and whether taxes should be increased and whether a combination of those two factors would lead to a lower deficit and thus what is always assumed to be greater confidence by money lenders who would then change the high real rate of interest and make things more comfortable.

That, in fact, would help all of us of course, whether it's home building or real estate or automobile or whatever else you can think about.

Now the administration, therefore, takes a dim view of proposals that appear to increase spending at this point. As a matter of fact, as has been pointed out already—and this subcommittee will be considering this starting next Monday—the administration has called for substantially less spending in the public housing area or the public expenditures for housing. Some would say so drastically less that it's a draconian change much as last year's was. So changes in that pattern are viewed as an increase in the deficit through the spending side.

Now along comes this bill, S. 2226. Is it an increase in spending? Apparently, it is. Dr. Hendershott said it may have been overstated by being characterized as a $5 billion expenditure; maybe it's only $2 billion. I think Dr. Swan said netting out everything over a course of years the cost would be one half or $2 billion, but it's more—more spending is involved, and the administration is trying to see if the income is coming in from all of this in the so-called summer of 1982, in the very short-term, worth that.

Is there any way out of this box we have been talking about? If so, it would seem that the administration may favor the proposal. If not, the administration probably will not favor it. Along with that, of course, there are many other proposals, some in the House and some in this body. They suggest that housing is a serious national dilemma and cannot be faced in such a narrow focus as we have, which may be, as Dr. Hendershott said, merely the building season of 1982. It may be broader than that. Some would think that it was. I would be among them.

In the event that the debate is to be whether we should try to solve the housing problem this year the adminstration is probably going to take a position that we should not, that in fact in the event that we are serious about deficits, interest rates and general economic recovery, that additional expenditures would not be possible. This is why we come to this particular moment and in this sequence.

Given the alternatives, as you have viewed them, not necessarily as I have characterized them, but the legislative possibilities as you view them, can you give us any advice as to how we ought to proceed? Because that advice would not only be welcome, but it's probably very timely and without it, it probably is not going to happen, and this is one reason for calling you on short notice for a very well informed panel discussion this morning.

Can I ask for your advice and counsel?

Mr. HENDERSHOTT. As long as I'm on the right, I'll start. I can't purport to speak for the administration. I suspect—and this isn't going to make anything easier for you—that the administration would probably view this bill and bills like it much more favorably if somehow the problems of the long-run deficit had been addressed. Until they are addressed, I think the administration will run scared on every item and will vote against every expenditure, except possibly for defense, that is proposed. I think you could make the case that this bill will not increase the deficit. It probably will lower the deficit for this year, but I don't find that to be terribly interesting or useful. If I were the administration, I would be a little worried about the fact that it adds a bit to the deficits in the future years, although what they are really worried about is—you know this better than I—opening up the gates for bailouts in umpteen different industries.

Senator LUGAR. Dr. Rosen.

Mr. ROSEN. I think the key thing to reducing the deficit—clearly, the compromises you're talking about between Congress and the administration have to be done, but the key is to get the economy growing. The deficit is due to the fact that we have a terrible economy. I think this is a way of beginning to get out of that. We have never had a recovery in the economy without housing leading the way. I don't think it's going to happen this time without housing. Nonresidential construction investment is not going to happen with capacity utilized at such a low level.

So I think it's really critical and I'm fortunate enough to be going to the White House this afternoon to talk to those very people that you mentioned at 2:30, and hopefully I can convince them of this. I'm not sure I'll be successful, but I'll make an attempt.

Senator LUGAR. Dr. Swan.

Mr. SWAN. If I thought the program might have a larger net impact, then there might be more of an argument for the program from the viewpoint of timing. But it is also important to remember that if the program works successfully, it will stimulate housing construction when adopted but at the cost of lower activity, and lower tax receipts, later on. If the initial stimulus were very large, there could be a large short-term stimulus to employment. But on balance, I think it isn't going to have a terribly large expansionary effect. Thus, I do not expect much of a short-run employment effect. The fundamental problem is resolving the conflict between what the course of fiscal policies over the next 3 to 5 years looks like vis-a-vis the current stance of monetary policy. That's an issue that goes beyond this bill.

Senator **Lugar**. Gentlemen, thank you very much for coming and being so forthcoming.

The Chair is pleased to welcome William Waller, of Tulsa, Okla., representing the U.S. League of Savings Associations; Felix Beck, Margaretten & Co., Perth Amboy, N.J., representing the Mortgage Bankers of America; and Harley W. Snyder, president-elect, National Association of Realtors, Valparaiso, Ind.

Gentlemen, we're pleased that you're here. Will you please present your testimony in the order I've introduced you.

STATEMENT OF WILLIAM WALLER, TULSA, OKLA., REPRESENTING U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. **Waller**. Thank you, Mr. Chairman.

As you indicated, I am William Waller. I am president of the State Federal Savings and Loan of Tulsa and appear today on behalf of the U.S. League.

The league welcomes this opportunity to support your bill, S. 2226, the Emergency Mortgage Interest Reduction Payment Act.

Attached to my prepared statement is a detailed section-by-section commentary.

S. 2226 addresses home affordability. It will help combat the collapse in homebuilding activity and unemployment—and without renewed activity in the housing sector, I firmly believe that a recovery from recession is impossible.

But there is more to achieving a housing recovery than lowering monthly payments to put homeownership within reach of a broader segment of the population. Someone familiar with conditions at the local level must make the construction loan and permanent takeout loans. The capital must be available.

Our savings and loan business can do that job, if we have the capital. We are the dependable source for housing credit, year-in and year-out.

But we are victims of the same interest rates which have brought the residential construction industry to its knees.

THREE-PART PROGRAM

Our organization, in conjunction with the savings banks, has been working on an integrated three-part program to sustain our thrift institutions in this crisis period and to stimulate homebuying activity at affordable rates.

My full statement discusses our proposal in greater detail.

Briefly, like S. 2226, we recommend a temporary interest-rate buydown. For the same $5 billion cost to the Treasury, we chose a broader base, including eligibility for purchasers of existing homes, and a shorter assistance period, 3, rather than 5 years. We envision lenders as well as the Government contributing to the buydown—$83 billion in mortgage lending would be stimulated, roughly 1.6 million units.

Unlike S. 2226, our proposal does not contain a repayment feature. The "growing equity" provision and the requirement, after the sixth year, of "equal monthly payments * * * to pay off the principal obligation" do create some technical problems. We would be pleased to explore these further with the staff, if you desire.

We have several other recommendations for the Lugar bill:

It should be clear that conventional loans, as well as FHA, are assisted, and that properties not necessarily built with FHA standards in mind, remain eligible.

It is important to move the unsold inventory as well as homes "completed on or after March 6th." We would recommend "previously unoccupied on March 6th" as a better benchmark.

We question why repayment should be triggered when borrowers decide to refinance.

Certainly, we do not agree with any implication that fixed-rate loans must be provided by the lenders after the equity buildup period.

Two of the three factors chosen for the allocation of loans State-by-State appear unrelated to housing demand.

From a lender's perspective, we have always found purchase price limitation more workable than determination of borrower income in these subsidized programs.

Finally, though I appreciate that it is not the subject matter of this hearing, I would ask, at the appropriate time, your sympathetic consideration of the other elements of our integrated plan: earnings assistance for institutions burdened with a legacy of low-yielding mortgages, and a program to sustain capital positions and suspend the ad hoc restructuring of our Nation's thrift business.

We can be the loan delivery system for S. 2226 and other housing programs if we can remain viable institutions in this time of crisis. Fundamentally, savings and loan managers remain committed to doing what they know best—serving the mortgage credit needs of their local communities.

I have appreciated this opportunity to present our views on the Emergency Mortgage Interest Reduction Payment Act, and look forward to your questions.

[Complete statement follows:]

STATEMENT OF WILLIAM WALLER ON BEHALF OF THE UNITED STATES LEAGUE OF SAVINGS ASSOCIATIONS

Mr. Chairman, my name is William Waller. I am president of State Federal Savings and Loan Association of Tulsa, Okla., and appear today on behalf of the United States League of Savings Associations,[1] where I am a member of the executive and legislative committees.

The U.S. League appreciates this opportunity to express its support for S. 2226, the Emergency Mortgage Interest Reduction Payment Act, introduced by you, Chairman Lugar, and 18 of your colleagues.

Attached to this testimony is a detailed section-by-section commentary on the provisions of S. 2226, as introduced. I will comment on some of the major points in a moment from the prospective of a home lender.

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[1] The U.S. League of Savings Associations has a membership of 4,100 savings and loan associations representing over 99 percent of the assets of the $650 billion savings and loan business. League membership includes all types of associations—Federal and State-chartered, stock and mutual. The principal officers are: Roy Green, chairman, Jacksonville, FL; Leonard Shane, vice chairman, Huntington Beach, CA; Stuart Davis, legislative chairman, Beverly Hills, CA; William B. O'Connell, president, Chicago, IL; Arthur Edgeworth, director, Washington Operations; Glen Troop, legislative director; and Phil Gasteyer, associate director, Washington Operations. League headquarters are at 111 East Wacker Drive, Chicago, IL 60601. The Washington Office is located at 1709 New York Avenue, NW., Washington, D.C. 20006. Telephone: (202) 637-8900.

This legislation addresses the important subject of home affordability in this period of near-record, high-mortgage rates. It provides a mechanism, through a temporary buy-down in interest rates, to achieve a surge of purchases of newly-constructed homes. This, in turn, will enable builders to resume construction. The unemployment so rampant in the construction trades and in supplier industries such as timber and lumber will be relieved.

Without renewed activity in the housing sector, we firmly believe that a recovery is impossible from the general recession which afflicts our economy.

There is more, of course, to achieving a housing recovery than designing a mechanism which puts monthly payments within reach of a broader segment of our population. The Congress cannot ignore the need for available credit in local communities to fund home loans. Home finance is also vital to our housing delivery system.

Form much of the last half century, the major source of mortgage finance has been our nation's thrift institutions—savings and loan asociations and mutual savings banks. As I'm sure you are aware, a financial crisis grips the thrift institutions of America. Last year a net $25 billion (withdrawals less new deposits) flowed out of our institutions. Because of the mismatch between the return on our long-term mortgage portfolios and our current cost-of-funds, we suffered operating losses of $5 billion in 1981. Yet, despite last year's deposit outflows and earnings losses, S&L's generated $45 billion in mortgage lending through mortgage repayments, sales and borrowings—far more than commercial banks or any other institutional source.

The Nation needs to preserve our savings and loan business * * * its dependable supplier of mortgage credit. That is not to say that the laws and regulations governing our institutions today are adequate; they are not. Last October we testified before your full committee in support of the "Garn Bill", S. 1720. Broader asset and liability powers are essential to our future, so that we may achieve some flexibility to sustain us in unstable and hostile economic climates.

Fundamentally, however, savings and loan managers remain committed to doing what they know best—serving the residential mortgage credit needs of their local communities.

High interest rates are at the heart of our problem—just as they are for the home-buyer and home builder. We appreciate that the Congress through its Budget process is working diligently to convince the marketplace that your fiscal course is a responsible one which will bring rates down. If interest rates don't come down and stay down, then the savings and loan business will inevitably require substantial financial assistance. We cannot wait for Wall Street to become convinced. We need a program put in place immediately. It will be much, much cheaper if rates fall over the next several months. But, the accumulated damage to date demands some assistance mechanisms for home finance right now—just as it needs S. 2226, without delay.

While we read of other intermediaries coming to the rescue of mortgage finance . . . commercial banks, pension funds . . . it is abundantly clear that they are either unwilling or unable to do so despite record earnings and effective tax burdens far less than those which apply to thrift institutions.

Our organization, in conjunction with the National Association of Mutual Savings Banks, has been working for several months on a three-part program to sustain our thrift institutions and stimulate home purchase activity at affordable rates.

Like S. 2226, our plan provides for a temporary interest-rate buy-down for home purchasers. Importantly, it also provides a short-term interest supplement to turn our portfolios filled with low-yielding mortgages into productive assets once again. If we can come closer to a break-even point on earnings, we can participate fully in homebuyer assistance plans such as S. 2226 or the one we have devised. (One-third of our assets return less than 9 percent; approximately two-thirds, less than 10½ percent; and only one-sixth more than 12 percent, the approximate level of 91-day Treasury bills today.) An interest-supplement for loans in portfolio earning less than 9 percent would cost the Federal Government $7.5 billion if Treasury 30-month rates persist at their mid-February levels (14 percent). We recognize that is a large price-tag . . . but, if earnings continue to decline at their present rate, more than one-third of our institutions will fall below critical net worth minimums by the end of next year. The $7.5 billion cost is roughly one-twelfth the cost of liquidating that many institutions; it is roughly one-sixth of the estimated cost of merging them into other financial institutions (assuming that many partners can be found).

(Our plan for making the low-yielding portfolios productive is not the only one; Chairman Lugar has introduced S. 1828, the "Thrift Partnership Tax Act", which we supported in testimony before the Finance Committee earlier this year. While the U.S. league applauded the concept, we questioned whether sufficient investors seeking tax losses are available to make much of a dent in our portfolio problem and whether the secondary market would be able to absorb the below-market loans acquired by the partnerships.)

The second part of our coordinated housing finance package does not involve direct Budget outlay. It is a capital maintenance plan utilizing an exchange of promissory notes carrying a Treasury guarantee of principal and interest for Income Capital Certificates (accepted as net worth by the Federal Home Loan Bank Board). This "swap" would sustain institutions at a positive 1.5 percent net worth level; legislation pending in the House of Representatives uses a similar mechanism and a 2-percent level. A cost to the Government, if any, would arise only in the event of liquidation of the assisted institution.

Of central importance, this capital maintenance plan would suspend the current ad hoc restructuring of our thrift industry by the regulatory agencies—and with it the disappearance of local, community-oriented savings and loan associations and mutual savings banks. It would "buy time" so that the Congress can put the country's fiscal house in order. Legislation like Chairman Garn's S. 1720 could be enacted and the modernization of financial services could proceed in a reasoned and systematic way.

The third part of our plan developed in concert with the National Association of Mutual Savings Banks would provide short-term assistance for homebuyers. Our program would provide an interest-rate "buy-down" available to a broad segment of the homebuying public. We propose that the Treasury (through appropriated funds) and home lending institutions both contribute to buy-down relief from current mortgage rates. Conventional loans would be available for one year at below-market rates using borrower and mortgage standards patterned after existing HUD middle-income programs (such as the FHA 235(q)). Lenders would contribute 1 percent toward the buy-down for the first three years of loan life; the Government would contribute 3 percent the first year, 2 percent the second, and 1 percent the third. (Buy-downs would be calculated from a general market index such as the FHLMC's composite monthly rate for conventional loans on existing homes.)

Thus, a buyer in a 16.5-percent mortgage market would be able to obtain a conventional loan at 12.5 percent at the outset, with the rate changing to 13.5 percent the following year, and 14.5 percent the third year. Using the suggested standards, this program could stimulate up to $83.5 billion in home mortgage lending in the coming year—which would finance about 1.6 million home sales. An estimated $7.5 billion in interest rate relief would be provided to borrowers—$5 billion (spread over three years) from the Government, and $2.5 billion contributed by participating lenders. This plan should be available for the purchase of both newly-constructed and existing homes—helping builders, realtors, building tradesmen, suppliers, home sellers, and, of course, families seeking homes.

This plan is obviously similar to that put forward in S. 2226. For the same cost to the Treasury, it assists more mortgages for a shorter period. Importantly, it would extend assistance to purchasers of existing as well as newly-constructed housing. (Approximately the same number of new homes are constructed with each.) Our surveys of homebuyers obtaining conventional mortgage loans indicate that almost 90 percent of purchasers of newly-constructed housing have previously owned a home. Thus, an effective assistance program must take into consideration the fact that many potential users must first sell their existing home before they can buy a new one.

Our plan also contemplates that thrift institutions and other lenders would contribute to the buy-down. This feature, of course, is predicated on the interest supplement of our portfolio assistance request—without which it will be very difficult to achieve the earnings needed for full participation in any buy-down program.

A third major difference between the joint U.S. League-N.A.M.S.B. homebuyer assistance plan and S. 2226 is the repayment made possible by the "growing equity" feature during the second through sixth years. This graduated, annual increase in payments toward principal, however, gives rise to a major question mark from the lender's point of view. It is not obvious to us that a loan with principal build-up for the first six years which reverts to fixed payments thereafter, will achieve the market rate of return stated at origination. (In simplified terms, a 16-percent mortgage, bought down for five years, with increases in principal through year six, does not return 16 percent if sold as would a fixed-rate 16-percent loan under standard amortization schedules.) If the market rate of return is atypical with the repayable interest reduction loans contemplated by S. 2226, then problems may arise with the willingness of lenders to undertake the program and secondary markets purchases of the loans originated.

We also question why "refinancing" should trigger repayment of the subsidy advanced by the Government under S. 2226. Frequently, borrowers refinance when mortgage rates decline substantially. But, in so doing, they do not have access to their equity to repay an obligation to the Government. Thus, section (e)(4) could deprive some consumers of a refinancing opportunity.

In another area, we do not see how the "equal monthly payments" requirement after the sixth year (Section (g)(5)) adds to the purposes of the bill. The experience of the last two and a half years has proven the folly of 25- and 30-year fixed-rate mortgage loans in an uncertain economic environment—a point recognized time and again by a majority of this Subcommittee throughout the last decade. (As we have testified repeatedly since the early 1970s, moving to variable and market-rate savings before we could reform our mortgage portfolios to varying returns "put the car before the horse".) In these periods of extraordinarily high interest rates, many borrowers, as well, prefer the adjustable rate mortgage option—in the expectation that rates will relax in the future, with lower monthly payments as a result.

We would also recommend the use of an established, external mortgage market index to determine the market rate from which buy downs are calculated. This could achieve some uniformity for the Federally subsidized assistance programs, perhaps State-by-State.

From a lender's perspective, we have always found purchase price limitations more workable than determinations of borrower income in subsidized programs.

Finally, our section-by-section commentary (attached) points out that the population and unemployment factors in the three-part formula for State allocation of funds bear little relationship to mortgage demand.

Mr. Chairman, these several observations are offered in the spirit of constructive criticism. We again affirm our overall support for S. 2226—which can play a vital role in stimulating a housing recovery.

That recovery depends upon adequate capital flows, too. Those can best be provided by a healthy savings and loan business, the traditional and dependable source of home finance. We want to help in the passage of S. 2226 . . . and we ask your help in restoring the vitality of our great industry through Federal assistance for our earnings and capital needs.

I have appreciated this opportunity to present the views of the U.S. League and look forward to your questions.

SECTION-BY-SECTION COMMENTS ON S. 2226, THE EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENT ACT—TO ACCOMPANY THE STATEMENT OF WILLIAM WALLER

SECTION (A)

The U.S. League applauds the decisions to include condominiums, units in cooperative housing and manufactured homes within the definition of newly-constructed homes eligible for purchase with assisted loans under the program. We would prefer, of course, to see a housing assistance effort aimed at buyers of both new and existing homes. Nine of ten buyers of newly-built homes must sell an existing home to undertake their new home purchase.

SECTION (B)

In the hope that the Government will succeed in restoring some stability to the economy—thereby reducing interest rates—it is most appropriate that a general market-related suspension point be provided for this assistance mechanism. The FHLBB'S index on conventional loan rates, averaging two months to allow for aberrations, is a good choice for this purpose.

SECTION (C)

We are unclear whether the langauge, as written, permits conventional as well as FHA loans to qualify for the interest reduction payments. (Since it is not amending one of the insurance sections of the National Housing Act, we assume it does.) Conventional loans have largely supplanted FHA loans in the mortgage markets and their use would greatly enhance the availability of this program to the public.

SECTION (D)

We have no objection to a potential "buy down" period of five years, though we would note that three-year adjustable and renegotiable-rate loan terms are now commonplace in the mortgage markets. It appears from subsequent provision (section (g)(5)) that a fixed-rate, long term loan is contemplated after the sixth year. Reverting to a fixed-rate loan could be a very serious drawback to the acceptability of this program by the homebuying public, lending institutions, and secondary market purchasers. The past fifteen years of rapidly rising market rates of interest and volatile rate cycles have seriously damaged all suppliers of long-term credit, whether corporate or municipal bond purchasers, or mortgage lenders. Depository institutions, such as savings and loan associations in particular, are reluctant to commit, as they did for four decades, to 25- and 30-year mortgages when their source of funds, saving deposits, is at the mercy of the wild swings in short-term market rates. (More than two-thirds of S&L deposits today are market-related.) In high-rate periods, many borrowers also desire the option of an adjustable mortgage where interest and monthly payments may decline in the future.

SECTION (E)

The formula for repayment by borrowers on sale, refinancing, etc. is the lesser of 60 percent of net equity or the amount of Government assistance. We are uncertain when the "net equity" is determined, though presumably this would be at time of disposition of the property. In addition, it is unclear what happens if for some reason home prices fall between the time of purchase and the subsequent sale. Is the assisted homebuyer then liable for the lesser of 60 percent of whatever was put forward originally as downpayment or the assistance payments received? This could mean an additional hardship to families already burdened with a loss by a fall in market prices. We might, therefore, suggest that language be added to provide that the borrower's liability for repayment be limited to the pay-down of his or her principal during the subsidy period.

We also question why the repayment to the Government should be triggered by "refinancing" as listed in subsection (4). Many borrowers refinance when mortgage rates decline to take advantage of more favorable credit terms. They do not, however, have access to their equity at that point to help them repay an obligation to the Government. Thus, subsection (4) could be a serious impediment to refinancings.

SECTION (F)

The U.S. League agrees that it is appropriate to establish a "floor" for the buy-down mechanism. The choice of 11 percent may be a bit lower than necessary as the cut-off point, however, since many market participants today expect a great demand for mortgage funds when rates reach 13 percent or 12 percent. In addition, while we appreciate the desire of the sponsors to minimize market interference, we would recommend use of a "market rate" definition from which buy-downs would be calculated. Unless such a standard is established, borrowers in the same circumstances purchasing homes at the same time in different parts of a State, or indeed within the same community, could receive widely different assistance levels—depending upon the lender chosen. We would suggest the Federal Home Loan Mortgage Corporation's rate for conventional loans on existing homes as an appropriate "market rate" from which to determine interest reductions for borrowers. This external standard is readily available to lenders and, we believe, could be provided State-by-State.

SECTION (G)

This section establishes family income, mortgage amount, owner-occupancy and several other "eligibility" criteria.

As the U.S. League testified before this Subcommittee several years ago, from a lender's viewpoint, a purchase price maximum is a much simpler way to administer subsidized housing programs than borrower income limitations. It should be recognized, as well, that so-called "upper bracket" home purchases remain possible under the standards set forth in this section (g). For example, there is nothing to prevent the purchase of a $200,000 dwelling where the borrower can put forward a $135,000 downpayment. Or, apparently, a two-income couple earning far more than $30,000 might qualify for these buy-down mortgages if one spouse had income of less than $30,000 and ownership was taken in that spouse's name.

We would recommend, as well, that either additional statutory or Committee Report language clarify the phrase "completed on or after March 6, 1982" in subsection (3). Homes essentially "finished" before that date could be altered in some way—by the addition of a porch, for instance—to create eligibility where none was intended.

In addition, as mentioned with our comments on section (d), the language of subsection (5) seems to imply that a fixed-rate loan must be provided after the six-year equity build-up period by requiring "equal monthly payments". This is an anachronistic restriction which could unnecessarily discourage lender participation in the program. It serves no purpose in accomplishing the basic home affordability and jobs creation goals of S. 2226, and we recommend that it be eliminated.

Furthermore, the implication of fixed payments beyond the sixth year raises serious doubts whether the face rate at time of loan origination (from which the buy-down is calculated) is truly a market rate of return. In graduated-payment and growing-equity mortgage plans we are familiar with, the initial period of variable payment is eventually compensated for by a subsequent payment schedule designed to achieve the market rate of return. Lenders will have to be convinced of the arithmetic of the S. 2226 plan to afford these loans their stated value in the marketplace.

We would also repeat our recommendation, made in various reviews of Truth-in-Lending and the Real Estate Settlement Procedures Act undertaken by your full Committee, that disclosures such as those required by subsection (6) should be provided by the realtor or builder—not the lending institution. Those professionals are the first ones encountered in the home delivery process; they are the ones who deal with the potential buyer at the point where decisions to purchase are made.

SECTION (H)

It should be recognized that two of the three parts of the formula chosen for allocation of interest-reduction funds by the HUD Secretary bear little or no relationship to the demand for newly-constructed housing. The first part of the apportionment formula, State population, obviously does not relate to building activity or potential activity: the population shift from the "Frost Belt" to the "Sun Belt" is well documented by the recent Census. Similarly, the general unemployment statistics are inappropriate. If the primary thrust of S. 2226 is to encourage "housing-related" jobs, we might suggest the use of unemployment in the construction trades, timber and lumber manufacture, or some similar, more-targetted measure. The third factor, decline in housing starts between 1978 and 1981, is more representative of new home demand—though, even here, there are some parts of the nation—such as Hawaii or perhaps States involved with the oil-shale boom—where the formula might be distorted.

SECTION (I)

We assume this Section, establishing the purchase authority for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, does not in any way restrict the activities of the so-called "private" secondary market. Depository institutions, mortgage banking firms, insurance companies, and pension funds buy and sell home loans among themselves in greater volume than the purchase programs of FHLMC and FNMA.

SECTIONS (J) AND (K)

No comment.

Senator LUGAR. Thank you very much, Mr. Waller, for your testimony.

Mr. BECK.

STATEMENT OF FELIX BECK, MARGARETTEN & CO., PERTH AMBOY, N.J., REPRESENTING MORTGAGE BANKERS OF AMERICA

Mr. BECK. Mr. Chairman and members of the subcommittee, my name is Felix Beck. I am chairman of the Board of Margaretten & Co., a Perth Amboy, N.J., mortgage banking firm, and, Mr. Chairman, I applaud you for the precise pronunciation of our name. It's not always quite so easy.

I appear today on behalf of the Mortgage Bankers Association to offer MBA's comments on S. 2226, a bill to provide emergency mortgage interest reduction payments.

Owning a home has been a dream deferred by thousands of potential home buyers in our Nation today. We are pleased that Chairman Lugar and the cosponsors of S. 2226 recognize the urgent need to defer that dream no longer and provide a means for young couples and families once again to own a home.

MBA supports the concept embodied in S. 2226 because we believe an immediate, temporary stimulus for the housing industry is needed to propel the economy out of recession and toward recovery. The way to provide that stimulus is to reduce mortgage interest rates so that middle income families can afford to buy new homes. S. 2226 would do that. The interest reduction program in S. 2226 promises to work quickly, to stimulate a large number of housing starts, and to cease operation if market interest rates subside from their current high levels.

Our detailed comments on the bill are contained in our written statement, that I ask be made a part of the hearing record.

Senator LUGAR. So ordered.

Mr. BECK. In the balance of my remarks, I would like to highlight certain aspects of S. 2226 and offer MBA's comments on those aspects.

MBA assumes that FHA-insured, VA-guaranteed, and conventional mortgages that meet the specifications in the bill will be eligible for assistance. However, we think the language in section 247(c) is not explicit on that point and we urge clarification.

The fact that FHA-insured and VA-guaranteed loans will be eligible for assistance under this program raises the question of the sufficiency of the FHA and Ginnie Mae commitment ceilings for both fiscal year 1982 and 1983. We urge Congress to reiterate the direction to the HUD Secretary to monitor carefully commitment activity for fiscal year 1982 and to report to Congress immediately if it appears those ceilings may be reached.

It is our understanding that this subcommittee will hold hearings next week on the 1982 HUD authorization bill that will contain fiscal year 1983 commitment ceilings for the FHA and Ginnie Mae programs. We urge this subcommittee to consider carefully the effects on FHA and Ginnie Mae activity that passage of S. 2226 will have, and to adjust the proposed commitment ceilings accordingly.

ELIGIBILITY STANDARDS FOR LOANS

Turning now to the eligibility standards for the loans, MBA urges that all new, unsold homes be made eligible for purchase with mortgages assisted under S. 2226. There are some 277,000 new, unsold homes in builders' and lenders' inventories. Many of these would become impossible to sell if S. 2226 were not changed in this regard. If inventory homes were eligible for assistance these builders and lenders would then be in a position either to build, or finance the building of, additional new homes. Thus, the aim of S. 2226, to stimulate additional new construction, would not be lost or diluted.

With respect to the mortgage and income limits, MBA urges flexibility tied to regional differences in home prices and incomes. This will allow the interest reduction program to be a truly national program accessible to middle-income families throughout the Nation.

MBA recognizes that amending the mortgage and income limits could reduce the number of units to be assisted. To offset that, at least in part, we suggest setting the minimum interest rate at 12 percent. Our calculations show that middle-income families could still afford these mortgages, and our members tell us there would still be a very strong market demand at 12 percent.

Finally, we urge that the November 1, 1982 deadline for commitment of assistance be moved to a date early in 1983, in order to allow HUD a bit more time to allocate $5 billion of assistance in an orderly and efficient manner.

Thank you very much.

[Complete statement follows:]

STATEMENT OF

FELIX M. BECK

CHAIRMAN OF THE BOARD
MARGARETTEN & COMPANY, INC.
PERTH AMBOY, NEW JERSEY

Mr. Chairman and members of the Subcommittee, my name is Felix Beck and I am Chairman of the Board of Margaretten & Company, a Perth Amboy, New Jersey, mortgage banking company. I appear today on behalf of the Mortgage Bankers Association* to offer MBA's comments on S 2226, a bill to provide for emergency interest reduction payments and for other purposes. Accompanying me are Burton Wood, MBA's Legislative Counsel, and Glen Corso, MBA's Deputy Legislative Counsel.

MBA supports the concept embodied in S 2226. As we detail in the Housing and Mortgage Market Outlook section, the housing industry is in dire straits and the severe slump in the industry's activity has permeated the entire economy. Unless and until housing begins to recover, the economy cannot and will not begin to climb out of the current recession. Housing is in need of a stimulus that will be quick acting, cost-effective, and temporary in nature. S 2226 should provide that kind of stimulus. Our more detailed comments on the bill, including suggestions for amendment and additions that we offer for Congressional consideration, follow the Housing and Mortgage Market Outlook.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance Companies
- Life Insurance Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Pension Funds
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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HOUSING AND MORTAGAGE MARKET OUTLOOK

The slow monetary growth philosophy of the Federal Reserve Board is a major cause of the depressed state of the housing industry. High financing costs for home builders and potential buyers kept 1981 housing starts below 1980 levels, slightly below 1.1 million total starts, the lowest volume in at least 20 years. Of this number, approximately 290,000 were multifamily starts, mostly condominiums. New residential construction in 1982 will be only slightly better, with starts for the year at a level no higher than 1.3 million units. Between 350,000 and 400,000 of the 1982 starts will be in multifamily structures, again predominantly condominiums. The outlook is somewhat clouded by the large stock of new and existing homes now on the market. As of January, 277,000 new housing units, not previously occupied, were for sale.

In the resale market, the problems are even more apparent. In 1981, existing home sales were only 2.35 million units, down 20 percent from 1980's depressed sales and almost 40 percent below the levels of 1978 and 1979. Most observers expect existing home sales to rebound to 2.5 million units this year.

Clearly, the low level of housing construction of the past two years has been a disaster for the industry. But it also represents a disaster for the consumer. Most estimates of population and household formation envision the decade of the Eighties as one of continued, increasing housing demand. While the general population will increase by 21 million people in this decade, the population of the prime first-time buying group, those between 25 and 34 years, will grow by nine million people. This growth will be three times faster than the overall population growth rate. Many analysts foresee a demand in excess of 2 million additional housing units per year during the next decade. Even with a limited housing recovery this year, 1982's projected 1.3 million starts will fall far short of demand. The following table shows the level of new housing starts over the past six years:

TABLE

Year	Private Housing Starts (Seasonally Adjusted Annual Rate)
1976	1,537,000
1977	1,987,000
1978	2,020,000
1979	1,745,000
1980	1,292,000
1981	1,084,000

Source: Dept. of Commerce, Bureau of the Census

Some of the shortfall in supply will be made up by the conversion of commercial properties to residential use. The shortgage of housing, however, in the face of strong potential demand will cause a significant increase in "doubling up", an eventual resumption of the upward spiral of home prices, and continued conversion of rental units to satisfy ownership demands. Countless American families will be forced to occupy rental housing far longer than they prefer, or perhaps forever.

An important issue of housing policy during the next twelve months, and quite conceivably for the entire decade of the Eighties, will be the affordability of housing. The current high interest rates have focused increasing concern on a problem that has been worsening for several years. The number of people who can afford to buy homes has been declining, and mortgage rates far above historical averages have exacerbated the problem.

For 1981, the median price of new one-family homes sold was $68,900. Assuming a normal downpayment of about 10 percent, the outstanding principal balance of a standard mortgage would exceed $62,000. With a level payment 30-year mortgage bearing a contract rate of 14 percent (the prevailing conventional commitment rate only one year ago), some 23 percent of American families could have afforded to buy that home. At 16 percent, only slightly more than 17 percent of those families could afford it. And at 18 percent mortgage rates, a level we have reached and even exceeded in some areas, the number of families that can afford this median price home falls to about 12 percent. Unable to qualify willing buyers for loans, the housing industry is moribund.

One critical cause of the affordability crisis in housing is the historically high cost of mortgage credit. Several factors are to blame—some macroeconomic or more general in nature and others related more directly to the severe plight of the mortgage lending industry. The general cause—inflation expectations, excessive Federal deficits, and restrictive monetary policy—are well known to the Subcommittee.

The problems specific to the mortgage lending industry have been all too well documented in the trade and financial press. Scores of savings and loan associations and mutual savings banks have been or are threatened with forced merger and acquisitions, or outright failure. Well-managed institutions, as well as poorly run firms, have been victimized by piecemeal deregulation during a period of extraordinarily adverse financial conditions. The mortgage banking industry, which in recent years has accounted for approximately one-quarter of residential loan orginations, has seen large and small firms—most of them successfully operated for decades—pushed into retrenchment, forced sales, and failures.

Under present economic conditions and prospects, the most optimistic forecast of mortgage rates during 1982 would be a low of 14 to 15 percent by early summer, with rates gradually rising during the second half of the year. This forecast results primarily from the overall easing of interest rates in response to the recession-induced weakness of business and consumer credit demands. Tight monetary policy and bloated credit demands rising from the huge Federal deficit mitigate against further declines in interest rates, while simultaneously exacerbating the crisis conditions plaguing mortgage lenders. Without immediate relief targeted toward the housing and mortgage markets, no better prospects can be projected in good faith.

The key roles played by the real estate, housing, and mortgage finance industries in the overall well-being of the U.S. economy cannot be overlooked. Without a recovery in these critical domestic industries, the outlook for a resumption of real growth in the economy generally is not favorable, and may be impossible, if the housing and mortgage lending industry crises continue with the full vigor that appears likely.

EMERGENCY HOUSING STIMULUS PROGRAM

MBA believes any emergency program designed to stimulate the housing industry should contain three elements in order to be most effective. An emergency program should be able to be implemented rapidly, in order to work its stimulative effect as quickly as possible. It should be as cost-effective as possible, so as to stimulate as many housing starts and as much economic activity as possible, for each dollar spent. Finally, an effective emergency program should be temporary in nature, so that once the stimulative effect is created, and the housing industry is on its way to recovery, the program will quickly phase down to avoid unnecessary costs.

S 2226, the "Emergency Mortgage Interest Reduction Payments" bill, appears to possess these three desirable elements. The use of existing Federal government apparatus in the Department of Housing and Urban Development (HUD) to implement and administer the program, together with the direction to the HUD Secretary to put the program into effect within 30 days after passage of the bill, should provide for the speediest start up possible.

The proposed act also seems to be relatively cost-effective. The interest reduction payments could reduce the interest rate on assisted mortgages to 11 percent or by 400 basis points, whichever would cost the Federal government less. Provision is made for the assistance extended by the Federal government to individual homeowners, to be recaptured upon sale, refinancing, or rental of the property securing the mortgage.

Finally, the program would be temporary, not only because the $5.2 billion authorization would place a definite limit on the total assistance available, but because the program could cease prior to all funds being committeed if the two month average on the Federal Home Loan Bank Board survey of loans closed reached 12.5 percent.

MBA believes S 2226 would provide a much needed stimulus to the housing industry. In the remainder of our testimony we offer a number of comments on specific provisons in the bill that we think would aid the proposed program to achieve its objective in the most effective and efficient manner possible.

TYPES OF LOANS ELIGIBLE

Section 247(c) appears to make loans other than those insured by the Federal Housing Administration (FHA) that conform to the requirements specified in Section 247, eligible for assistance under the provisions of this bill. MBA believes that both conventional loans and loans guaranteed by the Veterans Administration, that conform to the requirements of the legislation, should be eligible for the mortgage interest reduction payments specified by the bill in order to serve the broadest possible array of potential homebuyers. However, we are concerned that the language in Section 247(c) is somewhat ambiguous and we urge the Congress to clarify its intent. We also urge that conventional loans, eligible for mortgage interest reduction payments, with loan to value ratios in excess of 80 percent, be insured by a mortgage insurance company approved by the Secretary.

FHA-GNMA COMMITMENT CEILINGS

The FY 1982 commitment ceilings on the FHA mortgage insurance and Government National Mortgage Association (GNMA) mortgage-backed security (MBS) guaranty programs are $40 and $68.25 billion respectively. The ceilings have not yet been set for FY 1983, although the Administration has proposed an FHA ceiling of $35 billion and a GNMA-MBS ceiling of $38.4 billion, as part of its FY 1983 budget. Prior to S 2226's introduction, MBA had serious concerns that the Administration's proposed FHA and GNMA ceilings for FY 1983 were clearly inadequate, particularly if the housing industry enjoyed even a modest recovery in 1983. S 2226, if enacted, will require that the proposed FY 1983 ceilings will have to be set well above the levels set for FY 1982, based on objective estimates of the additional FHA and GNMA-MBS commitments that will be issued. In addition, if the bill is enacted within the next several months and provides the substantial initial increase in housing starts that is hoped for, we urge Congress to reiterate the direction given the HUD Secretary in the FY 82 HUD Appropriations Act (P.L. 97-101) to monitor carefully the FHA and GNMA commitment activity and to report to the appropriate Congressional Committees if it appears those ceilings will be reached. The commitment ceilings to be proposed for FY 1983, in the legislation to authorize the housing and community development programs administered by HUD, will be the subject of hearings by this Subcommittee next week. Our testimony at that time will deal with the subject at greater length.

SECONDARY MARKET ACCEPTANCE

It is difficult to predict precisely the secondary market acceptance of the mortgages that will be eligible for interest reduction payments under S 2226. These mortgages will embody several different characteristics, some known and some unfamiliar. The concept of a subsidy payment by the Federal government, paid on a monthly basis, designed to reduce the effective interest rate on a residential mortgage is a known concept. It is found in the FHA Section 235 homeownership program, which has successfully housed many low-income American families. A monthly payment that increases according to a predetermined schedule over a number of years is also a known concept. The FHA Section 245 program provides for a graduated payment mortgage. These loans have also been successfully marketed in the secondary mortgage market. The unknown concept contained in S 2226 is the combination of these ingredients, together with the idea of applying an increased portion of the monthly payment, at least for a certain period of time, to reducing the principal obligation of the loan.

In our opinion, the reaction of the secondary market to the new Section 247 loans should be favorable. The FHA-insured loans, and their VA-guaranteed counterparts if authority is forthcoming, will be eligible for placement in GNMA-MBS pools. The GNMA-MBS, as this Subcommittee well knows, enjoys widespread investor acceptability because of its liquidity and Federal government guaranty, which obviates the need for purchasers to possess an extensive knowledge of mortgages or residential finance. Placement of these loans in GNMA-MBS pools should greatly aid in achieving acceptability for the growing equity mortgages to be assisted under this bill. Specifically authorizing these mortgages as eligible for purchase by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) will also assist in creating a receptive secondary market for these mortgages.

One provision we would urge Congress to include is an enforceable due-on-sale clause. This will ensure that the average life of these mortgages is not stretched out because of assumptions, and should assist secondary market acceptability.

ELIGIBILITY REQUIREMENTS

Homes. In order to be eligible for assistance under S 2226 a mortgage has to be secured by a one- to four-unit dwelling, the construction or manufacture of which was completed on or after March 6, 1982. The apparent aim of this requirement is to stimulate new housing construction, rather than to provide financing for new homes currently in inventories. MBA urges the Subcommittee to amend this provision to allow these assisted mortgages to be used to buy all new, unsold homes.

The impact of this assistance program will be to bring on the market as many as 500,000 new housing units at a time when 277,000 new units are already for sale. If only the units completed after March 6, 1982 qualify for the assistance provided under this bill, then builders and lenders who own the standing inventory will be unable to sell any of it until the full five billion dollar program is completed. These builders and lenders, already devastated by high interest rates and poor business conditions not of their own making, would be injured by a government program that forced then to carry their inventory for an additional 6-12 months. By excluding the new home inventory Congress would be encouraging the private sector to devote the necessary resources for the construction of 500,000 new homes, while 277,000 homes stand vacant and unsaleable.

This provision would also jeopardize the assistance program by driving many builders and lenders—especially savings and loan associations and mutual savings banks—toward bankruptcy. We will need viable builders and lenders to implement this program and to contribute to the resulting economic recovery.

Income Limits. MBA recognizes the need for income limits for borrowers eligible for assisted mortgages under S 2226. However, we urge Congress to set an income limit that is a percentage of the median income for the area the home is located in, rather than a flat dollar amount. Such a limit would recognize the regional variances in both income and cost of living, and thus not penalize persons residing in areas with higher incomes and costs of living than the national averages.

Mortgage Limits. MBA urges that Section 247(g)(2) of the bill be amended to permit the maximum principal obligation on mortgages eligible for assistance be the applicable, maximum FHA mortgage amount for the area in which the home is located. Congress has given the HUD Secretary authority to increase the maximum FHA mortgage limit of $67,500 by 33 1/3 percent in areas where the Secretary determines that moderate and middle income families have limited housing opportunities due to high prevailing housing sales prices. This was done in recognition of the fact that there are substantial regional differences in the sales prices of homes. The cost of moderately priced housing in one area of the country may barely buy a garage in another area. Allowing the maximum FHA mortgage amount for the area to be the maximum amount for mortgages assisted under this bill would permit this to be a truly national program, available to assist potential homebuyers in all areas of the country, not simply those who reside in areas with more moderate housing costs.

INTEREST RATES

Section 247(f) sets the maximum assistance to reduce mortgage interest payments, to be the lesser of the amount necessary to reduce the rate on the loan to 11 percent, or by 400 basis points. Section 247(g)(9) authorizes the Secretary administratively to set the maximum interest rate on loans eligible for assistance. MBA urges Congress to amend Section 247(f) to provide that the maximum interest rate reduction will be to a level of 12 percent or by 400 basis points, whichever is less. MBA also urges that if there is a maximum rate to be set for loans assisted under this program, it should be the same as for loans insured under Section 203(b) of the National Housing Act, to facilitate placement of these loans into GNMA-MBS pools.

Setting the maximum interest rate buydown to 12 percent or 400 basis points would permit a larger number of mortgages to be assisted, and thus stimulate a greater number of housing starts for the same amount of money. At the same time, there should be no problem finding qualified buyers. Based on observations gathered from our members, a 12 percent interest rate would spark an enormous demand for housing from middle-income buyers. And a 12 percent interest rate would still permit these middle-income families to qualify for an assisted mortgage.

For example, a $65,000 mortgage with an 11 percent interest rate would require a monthly payment of $619.45. Using the guideline that no more than 30 percent of a borrower's gross monthly income should go for mortgage payments, requires a minimum annual income needed to carry that mortgage of $24,530. The same calculation at 12 precent produces an annual income eligibility figure of $26,486. Yet on that same $65,000 mortgage, the difference between an effective rate of 11 percent and 12 percent would reduce the maximum subsidy required by approximately $3,000 over the five year assistance period, assuming the mortgages are originated at contract interest rates of 15 percent or less. The increased number of mortgages that could be assisted, without a detrimental effect on demand or homeowner eligibility, argues strongly for increasing the maximum effective interest rate.

If Congress does decide to increase the maximum reduced interest rate to 12 percent, we would urge that Section 247(b), which provides for the shutdown of the program if market rates reach 12.5 percent, be eliminated, since there will be no need for it. The rates reflected in the Federal Home Loan Bank Board (FHLBB) closed loan index lag the market by approximately 30 days. By the time the FHLBB index for a two month period was at 12.5 percent, the true market rate could easily be at or below the maximum subsidized interest rate.

RECAPTURE

With respect to the recapture of the mortgage interest reduction assistance as provided for by Section 247(e), MBA has three suggestions.

MBA assumes that the purpose of the limitation on the amount of assistance to be recaptured is to ensure that homeowners will realize at least a portion of the proceeds from the sale of the home, less mortgage repayment, and thus have a continuing incentive to maintain the home and not to abandon it if they experience difficulty at some point in meeting the monthly payments. Based on that assumption, we do not urge Congress to require recapture of the full amount of assistance. However, we do urge Congress to consider increasing the percentage of net equity limitation beyond the 60 percent contained in S 2226. We believe the percentage of net equity available for recapture could be increased without damaging the incentive assumptions the limitation concept is based upon.

Second, it is unclear what is meant by the term "net equity." MBA urges that Congress statutorily define the term "net equity" rather than leaving the definition to be determined regulatorily by the Secretary. The definition of that term will determine the extent to which the Federal government will have a lien upon the property secured by the mortgage that received interest reduction payments under this proposed act. We respectfully suggest this important issue should be determined by Congress in the statutory language. It is important that the statute make clear the full extent of the homebuyer's responsibilty with respect to the recapture provisions.

Finally, we urge that Congress not enact Section 247(e)(2) which requires recapture of the assistance provided, when the owner ceases to occupy the property as a principal residence for a period longer than nine months. The enforcement of this section could work a great hardship upon those families who move involuntarily and are unable to sell their homes, or who plan to return to the area, and thus wish to rent their homes during the interim period. Additionally, the provision would be extremely difficult to enforce and could well result in a number of foreclosures and losses to the FHA insurance fund and the VA loan guaranty fund if the owners are unable to raise the money to repay the assistance.

Also, we urge that Section 247(e) be clarified to indicate whether the assistance provided a homeowner shall constitute a statutory lien upon the property or shall be evidenced by a second mortgage executed by the homeowner.

GROWING EQUITY FEATURE

Section 247(g)(4) provides that the mortgage payment shall be increased in years two through six of the loan by an amount equal to .75 percent of the original principal obligation of the loan and that such increase shall be applied to reduce the principal obligation of the loan. MBA urges Congress to revise this section in two respects. First, it should be made clear that the increase in the monthly payment of the mortgage shall be in an amount equal to one-twelth of an amount equal to .75 percent of the original principal obligation of the loan.

Second, if one object of the growing equity feature of the mortgage is to have the monthly payments increase in steps so that in year six the level of the monthly payment being made is equal to what the unassisted monthly payment is, to avoid a large jump in payments between years five and six, then the language in 247(g)(4) should be amended.

As presently written, Section 247(g)(4) would end the application of the increased payment to principle reduction one year after the interest reduction payments end. It appears from the explanatory material accompanying the bill that both should end in the same year and we urge amendment of Section 247(g)(4) to reflect that intention.

USE OF GNMA

In the interests of administrative flexibility, MBA suggests that Congress delete the reference to GNMA as the entity through which the assistance payments shall be made in Section 247(a). GNMA is an efficient, well run government corporation wholly contained within the Department of HUD. While endorsing its well-deserved reputation, we suggest that the determination of precisely which administrative unit within the Department is best able to handle the assistance payments, or whether all or part of the program should be handled by an outside entity, such as FNMA or the FHLMC, be left to the discretion of the Secretary.

ALLOCATIONS FORMULA AND RECAPTURE

MBA urges that the funds available be allocated by state strictly on the basis of need, rather than on the basis of any formula that attempts to quantify prior years' housing starts and unemployment. MBA also urges Congress to grant the HUD Secretary specific statutory authority to set an expiration date for commitments and to be able to recapture expired commitments and reallocate them on a discretionary basis according to need.

ELIGIBLE LENDERS

In the interest of administrative simplicity and efficiency, MBA urges that Section 247(g)(7) be amended to define eligible lenders as all lenders approved by the Secretary for participation in any mortgage insurance program under the National Housing Act, or any FNMA- or FHLMC-approved seller servicer.

ELIGIBILITY FOR PURCHASE

MBA urges Congress to amend Section 247(i) to make mortgages assisted under S 2226 eligible for purchase by all federally chartered institutions, to ensure that there will be no legal obstacles to these institutions investing in these assisted mortgages.

COMMITMENT DATE

Section 247(k) requires all assistance appropriated pursuant to S 2226 be committed by November 1, 1982. MBA urges Congress to change this date to sometime in early 1983. This will allow HUD some additional time to make a more orderly and less hectic allocation of commitments without unduly delaying the implementation of the program. Even if S 2226 is enacted into law by June, a November 1, 1982, cutoff date would only allow four months to commit $5 billion worth of assistance.

ADDITIONAL PROVISIONS

There are two additional provisions MBA urges Congress to consider adding to S 2226. One would be a provision that would authorize the Secretary to pay lenders a fee for the additional administrative processing involved in handling monthly subsidy payments. Such a fee is provided for under the Section 235 program and we urge inclusion of a similar provision in this bill.

Second, we urge Congress to consider a preemption of all state laws that would restrict or prohibit the origination, purchase, or sale of mortgages eligible for assistance under this bill. A number of states prohibit mortgages that do not have equal monthly payments, while several states prohibit mortgages whose monthly payments vary, unless the mortgage conforms to specific provisions in state law. We urge Congress to preempt all state laws, using that term in the broadest sense to include statutory law, common law, constitutional provisions, administrative regulations, and judicial decisions, that would prohibit or restrict the orgination of these mortgages.

Thank you very much for the opportunity to testify. I would be happy to try to answer any questions you might have.

Senator **Lugar**. Thank you very much, Mr. Beck.

The Chair calls now on Mr. Snyder to testify.

STATEMENT OF HARLEY W. SNYDER, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF REALTORS, VALPARAISO, IND.

Mr. **Snyder**. Thank you, Mr. Chairman.

My name is Harley W. Snyder. I am president-elect of the National Association of Realtors. I bring you greetings from all of your constituents in Valparaiso, Ind., sir.

It's our pleasure to be here today to comment on Senate bill 2226 and I would just say initially we are concerned that the relief provided for under S. 2226 will not come quickly and obviously because of the legislative process that must be gone through. We're concerned that the schedule that you propose in S. 2226 can only begin upon enactment and we are skeptical about whether or not that can be accomplished this year, and I think Mr. Hendershott commented before that he shared some of the same concerns.

EXISTING HOME SALES

We do have some basic concerns regarding S. 2226, one of which is that it ignores existing home sales. At the same time, however, it would provide for up to $12,754 over 5 years for a $67,000 mortgage, and our concern in that area seems to be that it might be an unnecessarily deep subsidy and the conservation of the Government's limited assets at this point in time are, in our opinion, paramount, or should be paramount.

We are concerned also about the question of the Federal intrusion into the conventional mortgage market that has a potential for abuse that has accompanied the federally related loan concept found in the Real Estate Settlement Procedures Act and the national flood insurance program.

RECAPTURE LANGUAGE

I think as it relates to the recapture language, we feel that that should be precise and should not be left to congressional intent or regulatory implementation. Just to comment on that, Senate bill 2226 requires recapture of Federal subsidy dollars equal to 60 percent of the net equity as determined by the Secretary. We don't believe that the Federal Government should be permitted the latitude to define net equity or its terms and further, the legislation should describe the relationship between net equity and appreciation, home improvements, and other such relevant concerns.

It further states that Federal assistance "shall constitute a second lien on the property and shall be repayable." We are uncertain as to whether this language provides for a second trust in the accepted sense of that term or whether the language used merely establishes a running meter of Federal recapture for 5 years, and we think clarification is needed on this point.

The assistance outlined in S. 2226 terminates when the Federal Home Loan Bank Board mortgage interest rate index falls below 12.5 percent. We are concerned that as it relates to that the effect in a volatile market would be that the program would shut down when it was still needed and perhaps continue or operate when unnecessary.

The administration, of course, as you are well aware, is attempting to reduce the influence of the Federal Government, via its New Federalism policy, and I guess we also have concerns in this area as to whether or not S. 2226 is perhaps out of step with the New Federalism approach.

I think we're very concerned, as you well know, sir, about the housing plight of this country and we feel that perhaps housing assistance might be better directed if it were allocated directly to the States. In many areas we may need assistance for existing home sales rather than just new construction, that the Federal Government would prescribe under S. 2226.

To take an example of that is the action taken last week by Maryland's Governor Hughes when he announced the utilization of the State pension funds whereby they would provide mortgage funds for the State through Fannie Mae. The pension funds will get a return of 16 percent while new construction would be available at 13.5 percent and existing home sales would be available at 15 percent. We are not suggesting, I might say, that the Federal Government provide that all 50 States use such a program, but I think if the Federal Government were to provide the buydown funds, the Maryland Fannie Mae program could work almost anywhere. If the Federal funds were to be mixed further with the developer, the home seller and/or funds, the program could help many more people than what it might intend to originally.

Our concern as it relates to Senate bill 2226 is that it doesn't address the whole problem of the industry. Mr. Rosen made a statement that S. 2226 guarantees that housing will recover. We submit that the demand is there, not just for new construction; rather, I think, that the demand is there for the total housing industry. I think, as you're well aware, by the end of January of this year, single family home sales had fallen to 1.8 million units, clearly, more than 50 percent under what the level had been in 1978, which relates to a $229 billion loss and 3.2 million home sales or resales in the existing homes market over that same period of time. We in the housing industry are in the worst depression since 1930 and I think as the panel said our concern is that the record deficits currently in existence within the Federal Government have contributed to that problem, record borrowing by the Federal Government, the hills and valleys going from a $60 billion surplus to a $200 billion deficit creates fluctuations that are almost impossible to live with in the credit markets.

Of course, all of this has caused record real estate interest rates, in many instances double and triple the normal levels. It's also resulted in a loss of up to 25 percent of the value of the average American's home and I think we have concerns that if this continues to go on—and I suppose it reflects on the recovery—we're going to have a recovery only at about one-half of the normal or anticipated rate.

Also, it's going to continue to cripple the interest-sensitive sectors of the economy, including small business, and I might say, in the mature regions of the country, the Northeast and the North Central regions more particularly.

I think it will lead to a greater economic concentration and conglomerate tie-in arrangements which will likely cause higher housing costs. I guess the bottom line is that housing, in our opinion, is in serious trouble and we have deep concern that it seems to be at a low point on the administration's agenda and—I might commend you, sir, that apparently up until your recent action—in many sectors of the Congress of the United States it seemed to be a low item on their agenda as well.

So we thank you for your interest there, Senator.

Single family production proposals, however, currently before the Congress would provide needed new employment but most of these proposals are not targeted to lower income groups that face particular difficulty in achieving homeownership and they all would require, of course, spending with consequent deficit increases, and I guess additionally, in our opinion, they are incomplete because existing home sales are not addressed in the areas that are being considered by the Congress and yet existing home sales is five-sixths of the housing activity, and to ignore this factor in the design of a production stimulus program is, in our opinion, to ignore the relationship between the sales of existing newly constructed homes.

I might say I'm a realtor. I also happen to be a homebuilder. The experience that I have would indicate the ratio of existing to new home sales shows that in the natural order of things several existing home sales occur before one new home sale. And while the impact in the economy per unit is not as dramatic as that of new construction, in the aggregate, existing sales have essentially the same macro impact in the economy because there are far more of them.

I think also, as it related to S. 2226, this would assist the purchase of newly constructed homes for families with an income of $30,000 and while this does not address itself to the first-time home buyer, in the opinion of some of us, we think that's basically where it's going to be.

The conventional market mortgage rate as of February 19, 1982, was 17.66 percent for an 80 percent loan on a nationwide average, and if we bought that rate down to 13.66 percent it would take a family of two with an income of $36,000 to qualify for a 95 percent loan.

Furthermore, many of the families that would qualify for the new program would be first-time homebuyers who by and large do not in our experience purchase new homes. The FHA/VA rate at the same time, incidentally, allowing the 95 percent loan value with 25 percent of income, going toward housing costs, would require an income of $32,352. That's utilizing the current FHA rate of 16.29 percent which would buy it down to 12.29 percent.

I think another area that concerns us is the recapture provision needs inflation to insure that the Government will recapture its subsidy. This means that a $70,000 home financed with a $67,500 mortgage must appreciate $21,250 or almost 30 percent for the Government to be entitled to its subsidy. The areas that qualify for assistance may not have appreciation sufficient to offset that subsidy. Of course, the repayment to the Government is interest-free, so the proportion must also be used in calculating the Federal cost.

I think the other thing that insofar as we're concerned in regard to existing family home sales, there is a spillover effect in existing single family home sales which I address briefly, in that many, many times the GNP is contributed to by virtue of the redecorating of homes, the recarpeting, new plumbing fixture, new appliances, which are generally, and more often than not, incorporated into a used or existing home sale. What we are saying is that what we think is needed is immediate short-term aid that avoids the Federal budget consequences that accompany the spending side solution, and we are concerned with the total home buying public and housing of all types. We think that there are a couple programs that might accomplish basically what you're suggesting and address themselves to new as well as existing home sales. Currently, the Congress is in conference on legislation, H.R. 4717, the Miscellaneous Revenue Act of 1981. We think that when the revenue program was authorized the Treasury cost estimates were placed at $15 to $20 billion. To date, there's still about $9 to $14 billion of those funds available. No additional funds would be required. Obviously, minor administrative and regulatory changes would be required in order to, in our opinion, accommodate 500,000 families which could be housed under this program within 1 year of the date these changes are adopted, 350,000 of which could achieve homeownership.

CREDIT AGAINST FEDERAL INCOME TAXES

Additionally, we think that the first-time home buyers could be allowed a credit against Federal income taxes of up to $5,400 on a purchase of a home between March 1 and December 31, 1982. This would result in 250,000 first-time home buyers who would not otherwise have been able to afford to buy a home being able to purchase a home in 1982 or, conversely, mortgage lenders could be able to take a credit against Federal income taxes of up to $5,400 if in fact these lenders would be required to decrease the effective rate of interest on the mortgage by 3 percentage points for a three-year period as a result of the buydown.

I think basically, Mr. Chairman, we are in a position where we would like to discuss some of these conditions with you and other members of the committee because I think, as I said, we recognize that you're interested in the housing industry just as keenly as we are and we thank you for the opportunity to appear here today.

[Complete statement follows:]

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
THE EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENT ACT
for the
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
of the
SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
by
HARLEY W. SNYDER
March 23, 1982

I am Harley W. Snyder, a REALTOR® from Valparaiso, Indiana and President-elect of the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the 700,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I appreciate this opportunity to present our views on the Emergency Mortgage Interest Reduction Payment Act (S.2226) recently introduced by Chairman Richard G. Lugar (R-Ind.).

STATE OF THE HOUSING INDUSTRY

Before I comment on S.2226 I would like to offer a few remarks regarding the condition of the housing industry as viewed from the Realtors® perspective. Our membership has suffered the effects of the current housing depression at least to the same extent as have other segments of the shelter industry and we are not without concern as to its duration. By the end of January 1982, sales of existing single-family homes on a nationwide basis had fallen to a seasonally adjusted annual rate of 1.8 million units — less than half of their previous peak level achieved in November of 1978. So far during this recession, 3.2 million resales with a market value of $229 billion have been lost. It should be noted that sales of existing homes traditionally comprise two-thirds of this nation's housing market.

For forty months now, we have watched housing activity steadily decline. This decline has accelerated during the last 12 months, to the point where we are immersed in the worst housing depression since the 1930's. The Federal government is the primary cause and that is because of:

- Record deficits as measured by current dollars, percent of the Gross National Product, or percent of personal or total savings — which is much higher than any other industrial country.
- Record borrowing by the Federal government for those deficits.
- Record seasonal borrowing from annual rates of $60 billion surplus in the second calendar quarter to $200 billion deficit in the fourth and first quarters which guarantees wide and harmful seasonal fluctuations in interest rates.
- Record removal of personal and other savings from use by housing and industry.

These events:

- Have resulted in record real estate interest rates, double and triple normal levels and much higher during this Congress and Administration than any other.
- Have caused the loss in the value of every American's home up to 25 percent and caused the loss in the value of the average American's savings and investment in housing by 50 percent.
- Will completely offset the stimulating effects of last year's tax incentives to invest even though that incentive was small compared to last year's tax incentive to consumers and small companies compared to the proportion of past tax relief measures.
- Will limit recovery to about one-half the normal rate.
- Thus, will provide only modest improvement in our nation's standard of living and a limited increase in jobs during the next three years.
- Will continue to cripple the interest-sensitive sectors of the United States economy, such as small business generally, automobiles, farming, exports and housing and the mature regions of the country, such as the Northeastern and North Central States.

- Will lead to greater economic concentration and conglomerate tying arrangements which will likely cause higher housing costs and less homeowner choices in financing and products and other services in the future.

As these factors indicate, housing is in serious trouble. We have been distressed to see housing at such a low point on the Administration's agenda. We hope to see the Administration be more supportive of housing in the future.

The Administration's current evaluation of its housing posture, through the President's Commission on Housing and the recently established Cabinet-level Housing Task Force chaired by Housing and Urban Development (HUD) Secretary Samuel R. Pierce, may indicate a growing perception within the Executive Branch of the current housing crisis. While we have disagreed with the thrust of the Commission's recommendations for the restructuring of the thrift industry, we have generally agreed with many of its proposals regarding homeownership and multi-family housing. We all await the Commission's final report, due April 30, 1982. In the interim, we hope the Housing Task Force will provide a clear indication that the Administration will provide positive support for the depressed housing industry.

The single-family production proposals now before Congress would provide needed employment in the construction trades and statistically improve sagging new starts. Most of these proposals are targeted to lower income groups that face particular difficulty in achieving homeownership. All would require federal spending with consequent deficit increases.

Our concerns with all of these programs, including S.2226 are as follows:

- The proposals are incomplete. REALTORS® conservatively estimate the existing home sales market to be five-sixths of the housing activity in this nation. To ignore this factor in the design of a production stimulus program is to ignore the relationship between the sales of existing and newly constructed homes.

- Federal buydowns for only newly constructed homes are purported to be employment programs that will bolster the Gross National Product (GNP). However, the loss in ancillary expenditures which are associated with the sale of existing homes are a part of current production and also represent substantial losses. These expenditures include the products and services used to prepare a house for resale, the utilization of real estate specialty services (real estate brokers, attorneys, lenders, etc) and after-sale expenditures for capital improvements in newly acquired homes. We estimate in excess of a $40 billion loss in GNP as a result of this situation.
- Congress is unlikely to quickly agree on any spending program to aid housing.
- Regulations necessary to implement any new stimulus program will further add to the delay. Relief, therefore, will not come until 1983, if it is in the form of a new construction program. The product will, as is often the case with production programs, arrive too late.
- Such a vast percentage of prospective homebuyers are now excluded from homeownership that any allocation system will be inequitable. The Subcommittee should consider that these families have strikingly high incomes in terms of area median income profiles.

What is needed is immediate, short-term aid that avoids the federal budget consequences that accompany spending side solutions. It is urgent that we get the existing housing market moving by the quickest means available and this in turn, will stimulate the market for newly constructed homes. Our concern is housing. Housing of all types. We hope that this is your concern too.

We recognize the Congress is composed of Committees that deal with segments of problems. We urge you to put aside these jurisdictional limitations and address the housing problem from the standpoint of developing a program that can be implemented quickly. One key to achieving a successful stimulus of the housing industry is to build on a program that is on the shelf, and not start from scratch. Currently the Congress is in Conference on legislation, H.R. 4717, the Miscellaneous Revenue Act of 1981, which contains changes to the Mortgage Revenue Bond Program. This Conference could provide a basis for housing recovery before the end of 1982.

When the Mortgage Revenue Program was authorized, Treasury cost estimates were placed at $15-20 billion. To date, $6.5 billion has been "consumed", leaving $9-14 billion available. No additional funds would be required for full implementation. Only minor, administrative and regulatory changes are necessary. These changes will increase the number of bonds that can be issued and make mortgages provided by the bonds more readily available. 500,000 families could achieve homeownership under this program within one year of the date these changes are adopted.

The NATIONAL ASSOCIATION OF REALTORS® also recommends:

- First-time homebuyers be allowed a credit against Federal income taxes of up to $5,400 on the purchase of a home between March 1 and December 31, 1982. The result would be that more than 250,000 first-time homebuyers, who would not otherwise have been able to afford a home, could purchase a home in 1982.
- Mortgage lenders be able to take a credit against Federal income taxes of up to $5,400 if they make home mortgages loans during the period March-December, 1982. In order to qualify for the credit, lenders would be required to use the amount of the credit to decrease the effective rate of interest on the mortgage by three percentage points for a three-year period.

Much, if not all, of the cost of such a tax credit program could be recouped through a curtailment of the existing All Savers program as of March 31, 1982, instead of its current ending date of December 31, 1982.

Revenue loss estimates for the All Savers program, at the time of enactment, were $3.3 billion. As of this date, some $700 million of that amount has been "consumed" by the issuance of All Savers Certificates, leaving $2.6 billion unused by the program. Current estimates are that the program will not be significantly expanded between now and March 31.

Although these recommendations are not specifically within the purview of this Subcommittee, it is important that we take note of them at this time for several reasons. First, as evidence that we are concerned with the current state of the housing industry and believe that something can be done to alleviate the distress without pursuing a spending-side solution that merely exacerbates the present budget deficit situation.

Second, we feel the revenue loss question has already been addressed in last year's tax bill and that our recommendations are merely a reallocation of those dollars for a broader purpose. And, third, this housing aid is clearly short-term and provides opportunity for early evaluation of its impact.

THE EMERGENCY MORTGAGE INTEREST REDUCTION PAYMENT ACT (S.2226)

Mr. Chairman, we have outlined our approach for a quick stimulus for housing. It provides quick relief and, as we point out, requires no new or additional federal expenditures. The relief provided in S.2226 will not come quickly. This delay is not by design, but rather is due to the legislative and bureaucratic process. S.2226 would require the HUD Secretary to "... issue final regulations, make allocations, and issue commitments....", all within 30 days after enactment of the necessary appropriation to fund S.2226. The rigorous schedule you propose in S.2226 can only begin upon enactment. When we look at the problems confronting the Congress this year and the major differences in approach between this Subcommittee and its House counterpart, we are skeptical that your program schedule can begin until much later this year.

Regarding the specific provisions of S.2226, we offer some observations:

- The legislation ignores existing home sales, a vital element in the housing market, and is therefore an inflexible assistance program that may not meet housing needs in many areas of the country.
- S. 2226 would provide up to $12,754 over five years for a $67,000 mortgage. This seems to be an unnecessarily deep subsidy to accomplish the stimulus purpose of this legislation. Conservation of limited federal assets is essential.

- The proposal raises the question of a federal intrusion into the conventional mortgage market that has the potential for abuse that has accompanied the "federally related loan" concept found in the Real Estate Settlement Procedures Act (RESPA) and the National Flood Insurance Program. The NATIONAL ASSOCIATION OF REALTORS® has long been concerned with the pressures that the federal government can bring on the housing market through an apparently inoccuous provision that provides a means for the government to control the sale and re-sale of homes. Recapture language should be precise and should not be left to Congressional intent or regulatory implementation. Further:

  — S. 2226 requires recapture of federal subsidy dollars equal to 60 percent of "... net equity as determined by the Secretary." We do not believe the Federal government should be permitted the latitude to define "net equity" or its terms. The legislation should describe the relationship between "net equity" and appreciation, home improvements, and such other relevant concerns.

  — S. 2226 states that federal assistance "... shall constitute a second lien in the property —— and shall be repayable." We are uncertain as to whether this language provides for a second trust in the accepted snese of that term, or whether the landuage used merely establishes a "running meter" of federal expenditures for five years. Clarification is needed on this point.

- The assistance outlined in S.2226 terminates when the Federal Home Loan Bank Board's home mortgage interest rate index falls below 12.5 percent. This is an unfortunate choice because that index is slow to reflect interest rate changes. The effect in a volatile market would be that the program would shut down when still needed or continue to operate when unnecessary.

The Administration is presently attempting to reduce the influence of the Federal government via its New Federalism policy. I might add that the NATIONAL ASSOCIATION OF REALTORS® is totally supportive of the New Federalism approach. It seems, then, that the complex federal mechanism for assistance outlined in S.2226 is totally out of step with the thrust of New Federalism.

The NATIONAL ASSOCIATION OF REALTORS® recommends that housing assistance funds be allocated directly to the states. At the state level, the true housing needs can be better determined as in any process that decentralizes decision-making. It must be remembered that Washington is not the repository of all wisdom. For example, many areas may need assistance for existing home sales, rather than just the new construction that the Federal government would proscribe under S.2226.

Take, for instance, last week's action in Maryland when Governor Hughes announced the state pension funds would provide mortgage funds for that state through the Federal National Mortgage Association (FNMA) mortgage-backed securities. The pension fund will get a return of 16 percent while builders can buydown rates to 13 1/2 percent for new construction, and homesellers can buydown rates to 15 percent for resales of existing property. The next day, Maryland announced further housing assistance for lower income families through the issuance of tax-exempt bonds.

If the Federal government were to provide the buydown funds, this Maryland/FNMA program could work almost anywhere. Similaryly, federal funds could be used to off-set part of a state's revenue loss if it also issued tax-exempt bonds. If federal funds were to be mixed with developer, homeseller, and/or funds, the program could help many more people.

We are not suggesting that all 50 states use a program similar to that in Maryland, but, given the new changes taking place in the marketplace, states would, no doubt, have a variety of options from which to choose. This approach is likely to be quicker and get more "bang for the buck" than the approach outlined in S.2226.

S.2226 would be a much more effective proposal if it worked with the private marketplace and state governments without copious federal regulation. We would be happy to work with the Subcommittee in this regard.

Thank you, Mr. Chairman.

NATIONAL ASSOCIATION OF REALTORS®
HOUSING PROPOSALS

America's Housing Industry is in a Depression:

- The current slump in home sales is five times worse than at any time in the post-war period . . .

- Economic activity associated with housing construction and sales which has been lost in the last three years amounts to almost $200 billion . . .

- Over two million housing and related jobs have been lost since 1980 . . .

- Only five percent of non-home owners can qualify for an 80 percent mortgage on a median-priced home, and lenders have effectively shut the window on mortgage lending activity . . . .

SUMMARY

The NATIONAL ASSOCIATION OF REALTORS® recommends consideration be given the following:

- Provide administrative and legislative changes to the Mortgage Revenue Bond program to increase the number of bonds that can be issued and make mortgages provided by the bonds more widely available. Necessary administrative changes would be to increase the number of areas nationwide that are targeted areas or areas of chronic economic distress and make minor revisions in the arbitrage limitation in order to increase bond security. Legislative changes would increase, through 1982, the price of homes that can be financed under this program, increase the total amount of mortgage bonds that can be issued, and increase the arbitrage limitation to 1.25%. 500,000 families could achieve homeownership under this program within one year of the date these changes are adopted.

- Allow first-time homebuyers a credit against Federal income taxes of up to $5400 on the purchase of a home between March 1 and December 31, 1982. The result would be that more than 250,000 first-time homebuyers, who would not otherwise have been able to afford a home, could purchase a home in 1982.

- Allow mortgage lenders a credit against Federal income taxes of up to $5400 if they make home mortgage loans during the period March-December 1982. In order to qualify for the credit, lenders would be required to use the amount of the credit to decrease the effective rate of interest on the mortgage by three percentage points for a three-year period. The result would be that homebuyers could more easily qualify for the loan at the reduced rate of interest and, more importantly, could afford monthly principal and interest payments on such a mortgage.

The means of recovery are at hand if Congress and the Administration will act:

On the statute books is the Mortgage Revenue Bond Tax Act of 1980, which expires December 31, 1983. With the correct stimulus from administrative and legislative changes, it could provide a basis for recovery before the end of 1982.

PROPOSAL NUMBER 1: MORTGAGE REVENUE BOND TAX ACT OF 1980: ADMINISTRATIVE CHANGES

First, based on a reading of the last year of experience with this program, two things are clear: while mortgage bond activity in 1981 was slow (totalling less than $6.5 billion out of a potential $15-20 billion) technical changes made by IRS in the last weeks of 1981 resulted in a surge of bond activity, as restraints on the program were relaxed somewhat. Those changes by IRS accounted for about 55 percent of total bond offerings being made in the last months of 1981.

Second, according to the Council of State Housing Agencies, further administrative changes could generate an additional $7-8 billion in bond activity within the next six weeks and a further $2-3 billion by June 1982 if the following changes are made in the program by the Administration:

- Increase the number of standard metropolitan statistical areas which are in "chronic economic distress" or targeted areas. In such areas, homes valued at 110% of the average sales price would qualify for the tax-exempt bonds. In non-chronic distress areas, homes qualify at or under 90 percent of the average sales price. This change has two practical effects. First, more homes qualify for the program, and more families with moderate incomes qualify, thus strengthening the loans made and accordingly strengthening the quality of the bond offering.

- Delete the provision in section 6a.103A-2(b)(5) of the mortgage bond regulations that limits to 20% the population of a State that can be considered to live in targeted areas. If this were done, many more areas could be designated as targeted areas, thus increasing to 110% from 90% the average purchase price of a home that can be financed under the bond program. The function of the Federal government, under the Mortgage Bond Act, is simply to approve or disapprove areas selected by a State as areas of chronic economic distress, based upon criteria set forth in the Act. If more than 20% of a States's population lives in areas of chronic economic distress according to these criteria, the Federal government should approve the designation and not artificially limit such areas by regulation.

- In order to remove resistance from state and municipal housing agencies, the following changes should be made with respect to arbitrage provisions of the Act in order to effectively raise the arbitrage rate:

    1. Allow issuers to charge a 1% refundable origination fee, payable by mortgage holders, to protect the issuer against loss in the loan acquisition period subsequent to the issuance of the bonds. Assuming that the bond proceeds may

be temporarily invested at 12% (the bond yield being 14%), on a $100 million issue the issuer would sustain a $500,000 loss during the loan acquisition period assuming the mortgage loans are made evenly over the 12-month period immediately following issuance of the bonds. We would propose that any such origination funds not used be considered arbitrage earning to be refunded to borrowers under current law.

2. Allow prepayment penalties collected during the first six years of a bond issue to be excluded from the calculation of bond yield. This would provide security against earlier than anticipated prepayment of loans, but would only reimburse the issuer for the original cost of issuance.

3. Allow issuers to retain arbitrage profits, rather than rebate them to the federal government, in any case where the rebate would reduce the amount held by the issuer to less than 2 percent of bonds outstanding. This is a security feature in that it protects the issuer against loss in the event that losses accumulate shortly after arbitrage profits have been rebated.

4. Allow arbitrage profits to be used to pay for unamortised costs of issuance on bonds called because of prepayments, but only to the extent such costs are not covered by a prepayment penalty.

RECOMMENDED LEGISLATIVE CHANGES IN THE MORTGAGE BOND PROGRAM

Once these changes are in place, the bond program will be moving further ahead, and will make it easier for Congress—if pushed by the Administration—to make further necessary changes. Specifically, the following changes are recommended for inclusion in legislation:

- Raise the qualifying limit (until January 1, 1983) from 90 to 110 percent of the average sales price in non-targeted areas, thus qualifying more homes for financing with revenue bonds and increasing the number of moderate income families who can acquire such financing.

- Increase to $400 million from $200 million the aggregate amount of bonds that can be issued by any state during any calendar year.

- Increase the arbitrage limit to at least 1.25% from 1%. The current limit is simply too low to allow issuers to recoup the costs of issuing the bonds and administering the program.

- Modify the current requirement that 20% of a multi-family housing project be occupied for the duration of the bond issuance by persons of low or moderate income so that this requirement extends only 10 years from the date the project is first occupied. In many cases, this requirement cannot be met for the duration of the bond issuance because of increasing costs as a building becomes older and because of changing neighborhoods.

By adopting these administrative and legislative changes and thereby removing current impediments to the issuance of mortgage bonds, an additional 300,000 families could achieve homeownership within one year.

Where's the Money Coming From?

When the Mortgage Revenue Bond Program was authorized, Treasury cost estimates were placed at $15-20 billion. To date, $6.5 billion has been "consumed", leaving $9-14 billion available. No additional funds would be required for full implementation of the above recommended regulatory and legislative changes.

THE KEY TO ACHIEVING A SUCCESSFUL STIMULUS OF THE HOUSING INDUSTRY IS TO BUILD ON A PROGRAM THAT IS ON THE SHELF, AND NOT TO START FROM SCRATCH. CURRENTLY, CONGRESS IS IN CONFERENCE ON LEGISLATION, H.R.4717, THE MISCELLANEOUS REVENUE ACT OF 1981, WHICH CONTAINS CHANGES TO THE MORTGAGE BOND PROGRAM. THIS CONFERENCE COULD PROVIDE THE CONTEXT OF ENACTING THE LEGISLATIVE CHANGES ABOVE.

PROPOSAL NUMBER 2: TAX CREDIT FOR FIRST TIME HOMEBUYERS

The NATIONAL ASSOCIATION OF REALTORS® proposes that first-time homebuyers be entitled to a credit against Federal income taxes on the purchase of a home from March 1, 1982 to December 31, 1982. The result would be that more than 250,000 first-time homebuyers could purchase a home this year.

Essential Elements of the Proposal Are:

- The credit would be equal to 9 percent of the amount of the first trust mortgage (up to a maximum credit of $3400) on the home originated on or after March 1, 1982.

- The purchaser, in order to have the credit immediately available for downpayment purposes or to "buy-down" the interest rate on the mortgage, could claim the credit against taxes due or paid in the preceding three years by filing amended tax returns for those years or it could be used to offset taxes due for 1982.

- A first-time homebuyer would be defined as an individual who has not owned a home in the preceding three-year period.

Where's the Money Coming From?

Much, if not all, of the cost of such a program could be recouped through a curtailment of the existing All-Savers program as of March 31, 1982, instead of its current ending date of December 31, 1982.

Revenue loss estimates for the All-Savers program, at the time of enactment, were $3.3 billion. As of this date, some $700 million of that amount has been "consumed" by the issuance of All-Savers Certificates, leaving $2.6 billion unused by the program. Current estimates are that the program will not be significantly expanded between now and March 31.

By curtailing the All-Savers program as of March 31, and transferring the remaining unused revenues, some 500,000 first-time homebuyers could obtain the maximum tax credit without further impacting the estimated deficit. By requiring recapture of the credit for homes sold within three years, revenues would be generated which would provide an additional 100,000 first-time homebuyers the maximum credit. Further, because not every first-time homebuyer will purchase a home with the maximum allowable mortgage amount, revenue losses will not total the absolute maximum projected.

MAXIMUM REVENUE LOSS FROM TAX CREDIT TO FIRST TIME HOMEBUYERS

	TOTAL	LAST HALF FY '82	1st QTR FY '83	REMAINDER OF FY '83-FY '85
Projected Qualifying Sales	700,000	450,000	250,000	0
Maximum Revenue Loss (in billions)	$3.78	$2.43	$1.35	$0
Recapture (in billions)	0.38	0.12	0.12	0.14
Net Loss (in billions)	3.40	2.31	1.23	(.14)
Offset through curtailment of All-Savers program	2.61	1.74	0.87	0
Net Revenue Loss (in billions)	0.79	0.57	0.36	(.14)
Revenue Gain From Additional Home Sales and Employment	1.40	0.90	0.50	0
Revenue Gain From Tax Credit As Substitute For All-Savers Certificates and With Improved Home Sales and Employment	0.61	0.33	0.14	0.14

Advantages of this proposal are:

1. Provides direct benefit to every first-time homebuyer who purchases a home during the period March-December 1982.

2. Allows the homebuyer immediate access to the benefit by allowing the credit to be carried back to 1981 and 1980 taxes rather than forcing the homebuyer to wait and receive the benefit when 1982 tax returns are due.

3. Gives the homebuyer the option to use the tax credit as part of the downpayment on the home or to "buy-down" the interest rate on the mortgage.

4. Applicable to home purchases involving both institutional and non-institutional lenders. This is important because over 70% of home sales currently involve non-institutional or "creative" financing. The tax credit program should not discriminate against any type of financing.

5. Benefits both the new and existing home market. A first-time homebuyer could choose to purchase new or existing homes under the proposal. Both purchases create jobs. An existing homesale stimulates fix-up purchases and jobs; services at the time of transfer; and remodeling or purchases of appliances, drapes and carpets after the purchase. New homesales stimulate construction jobs and purchases of durable goods. First-time homeowners typically buy existing homes but the ripple effect would result in new home sales initially stimulated by the purchase of the existing home.

The following table shows how the tax credit would be computed for various mortgage amounts.

TAX CREDIT AVAILABLE TO FIRST-TIME HOMEBUYERS ACCORDING TO MORTGAGE AMOUNT

Mortgage Amount	Tax Credit
$20,000	$1,800
30,000	2,700
40,000	3,600
50,000	4,500
60,000	5,400

Homebuyers would benefit because the credit could be used to increase the downpayment or reduce the effective interest paid as the result of a "buy-down" of the rate with the lending institution. The following tables illustrate the reduction in monthly mortgage payments that could be possible if the credit were so used.

POSSIBLE REDUCTIONS IN MONTHLY MORTGAGE PRINCIPAL AND INTEREST PAYMENT ASSUMING TAX CREDIT IS USED TO INCREASE DOWNPAYMENT

($60,000 MORTGAGE, 30 YEARS)

INTEREST RATES	AMOUNT OF TAX CREDIT AVAILABLE	MONTHLY PRINCIPAL AND MORTGAGE INTEREST PAYMENT WITHOUT CREDIT	MONTHLY MORTGAGE PRINCIPAL AND INTEREST PAYMENT IF CREDIT IS USED TO INCREASE DOWNPAYMENT	MONTHLY DOLLAR SAVINGS IN PRINCIPAL AND INTEREST PAYMENTS	YEARLY DOLLAR SAVINGS ON PRINCIPAL AND INTEREST PAYMENTS
17%	$5400	$855	$778	$77	$924
16	5400	808	736	72	864
15	5400	758	690	68	816

POSSIBLE DOLLAR SAVINGS TO HOMEBUYER IF TAX CREDIT WERE USED TO "BUY DOWN" INTEREST RATE FOR THREE YEARS

($60,000 MORTGAGE, 30 YEARS)

INTEREST RATE	TAX CREDIT	MONTHLY MORTGAGE PRINCIPAL AND INTEREST PAYMENT WITHOUT REDUCTION	MONTHLY MORTGAGE PRINCIPAL AND INTEREST PAYMENT FOR THREE YEARS WITH THREE PERCENT REDUCTION OF RATE	DOLLAR SAVINGS PER MONTH	DOLLAR SAVINGS PR. YEAR
17%	$5400	$855	$710	$145	$1740
16	5400	806	663	143	1716
15	5400	758	617	141	1692

PROPOSAL NUMBER 3: TAX CREDIT FOR MORTGAGE LENDERS

The NATIONAL ASSOCIATION OF REALTORS® proposes that mortgage lenders be entitled to a tax credit if they make home mortgage loans to first-time homebuyers during the period of March through December 1982. In order to qualify for the credit, lenders would be required to use the amount of the credit to decrease the effective rate of interest on the mortgage by three percentage points for a three-year period. The result would be that homebuyers could more easily qualify for the loan at the reduced rate of interest and, more importantly, could afford monthly principal and interest payments on such a mortgage.

ESSENTIAL ELEMENTS OF THE PROPOSAL:

- The credit would be calculated based upon the amount necessary (up to $5,400) to reduce the effective interest rate on the first $60,000 principal amount of the mortgage by three percentage points for a three-year period. This would greatly reduce revenue losses as the Administration's interest rate targets are achieved.

- To help assure that the entire benefit of the reduction in effective rates is passed on to consumers, the credit would be determined based upon the amount necessary to reduce market rates by the required percentage rather than the mortgage in question. The market rate would be the published FHA average first trust mortgage rate.

- The credit could be carried-back and carried forward by the lender under current investment tax credit rules. In addition, although the total amount of the credit would be determined at the time the loan was made, the lender would be required to use the credit against income over a three-year period, the same period during which the interest rate on the mortgage was reduced. Thus, one third of the credit could be used each year.

Below is the projected revenue loss from this tax credit proposal. It should be noted that two-thirds of the loss fall within FY 1982.

MAXIMUM REVENUE LOSS FROM TAX CREDIT TO FINANCIAL INSTITUTIONS

	Total	FY 82	FY 83 1st Qtr	Remainder FY 83-FY 84	FY 85
Projected Qualifying Sales	700,000	450,000	250,000	0	0
Maximum Revenue loss (in billions)	3.78	.80	1.25	1.25	.48
Recapture (in billions)	.38	.12	.12	.10	.04
Net loss (in billions)	3.40	.68	1.13	1.15	.44
Offset through curtailment of All-Savers program	2.61	1.74	.87	0	0
Net loss with All Savers Certificates	0.79	(1.06)	0.26	1.15	0.44
Gain in tax receipts from resulting higher employment, sales and income	1.40	0.90	0.50	0	0
Net revenue gains	0.61	1.96	0.24	(1.15)	(0.44)

The following tables show how the credit would be calculated on a $60,000 mortgage at various levels and the dollar savings to homebuyers.

POSSIBLE DOLLAR SAVINGS TO HOMEBUYER ON MONTHLY MORTGAGE PAYMENT FOR PRINCIPAL AND INTEREST

MORTGAGE INTEREST RATE WITHOUT CREDIT	MORTGAGE INTEREST RATE WITH CREDIT	MONTHLY PAYMENT FOR PRINCIPAL AND INTEREST WITHOUT CREDIT	MONTHLY PAYMENT FOR PRINCIPAL AND INTEREST WITH CREDIT	DOLLAR SAVINGS PER MONTH	DOLLAR SAVINGS PER YEAR
17%	14%	$855	$710	$145	$1740
16	13	806	663	143	1716
15	12	758	617	141	1692

The advantages of this proposal are:

1. Provides an immediate direct benefit to every first-time homebuyer who purchases a home during the period March-December 1982.

2. Allows the homebuyer to immediately receive the benefit of the credit through reduced monthly payments.

3. Allows more first-time homebuyers to qualify for a mortgage on a home and makes the homebuyer better able to meet the monthly principal and interest.

4. Applicable to any mortgage lender providing a mortgage on a home. In this way this proposal does not discriminate against non-institutional lenders. This so-called people-to-people financing is involved in over 70% of home sales in the current market.

5. Benefits both the new and existing home market. Homebuyers could choose to purchase new or existing homes under the proposal. New home sales would be particularly stimulated because owners of existing homes, who are ready to improve their housing, will be able to find buyers for their homes and will therefore be able to purchase new homes.

Senator LUGAR. Well, gentlemen, I thank all three of you for your patience in waiting through the 3 hours of our hearing this morning. I hope you've found it as interesting as I have.

The hearing is adjourned.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

[Additional material received for the Record follows:]

BY AUTHORITY

RESOLUTION NO. 17
SERIES OF 1982

INTRODUCED BY
Reynolds and Swalm

A RESOLUTION

SUPPORTING THE HOUSING POLICY OF THE NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS (NAHRO) ALLOWING PUBLIC HOUSING AUTHORITIES TO ESTABLISH A FLEXIBLE RENT STRUCTURE.

WHEREAS, the Housing Authority of the City and County of Denver is required to establish a tenant-rent structure pursuant to State and Federal laws; and

WHEREAS, from 1937 to 1971, the Housing Authority complied with State law which has allowed the establishment of flat rents for tenants receiving public assistance; the rent for public assistance equaled monthly operating costs and therefore the Authority required no federally assisted operating subsidy; and

WHEREAS, in 1970 and 1971 Congress passed the Brooke Amendments to the Federal Housing Statutes which established a maximum rent-to-income ratio not to exceed 25% of each tenant's adjusted income; the implementation of the Brooke Amendments necessitated an annual operating subsidy from the Department of Housing and Urban Development and prohibited the Housing Authority from increasing its rental income; and

WHEREAS, since 1980 the Congressional appropriations of operating subsidy have not been sufficient to fully subsidize the Housing Authority;

BE IT RESOLVED BY THE COUNCIL OF THE CITY AND COUNTY OF DENVER:

Section 1. That the City Council of the City and County of Denver advocate the repeal of the Brooke Amendments.

Section 2. That the City Council support the housing policy of the National Association of Housing and Redevelopment Officials (NAHRO) which will allow local public housing authorities to establish a flexible rent structure which will decrease the dependency of housing authorities on federal operating subsidies and allow the establishment of flat rents and return local decision making to the local Authority's Board of Commissioners.

Section 3. That the Clerk of the City and County of Denver forward a copy of this Resolution to the Colorado Congressional delegation and appropriate Congressional committees, and attest and affix the Seal of the City and County of Denver to this resolution.

PASSED BY THE COUNCIL March 15, 1982

William R Roberts - President

APPROVE: W H McNichols - Mayor March 17, 1982

ATTEST: - Clerk and Recorder,
Ex-Officio Clerk of the
City and County of Denver

STATEMENT OF

ROBERT A. GEORGINE, PRESIDENT

BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

I welcome the opportunity to submit for the record this statement of the views of the Building and Construction Trades Department, AFL-CIO, on S.2226, the Emergency Mortgage Interest Reduction Payment Act.

Certainly, the nation's full economic recovery is predicated upon a real recovery in the construction industry. This bill is commendable, as it promotes the creation of jobs in residential construction and housing-related industries, while encouraging home ownership for low and middle income families.

It has been estimated that at current interest rate levels, only 4 percent of American families can afford to carry a new mortgage on even a modest home. The provisions of S. 2226 would assist families whose annual adjusted gross income did not exceed $30,000.00 in purchasing a single family home, manufactured home, or membership in a cooperative. Eligible families could take advantage of a subsidized interest rate for a five-year period, giving many more the opportunity to own a home.

Further, the bill would provide an estimated 700,000 jobs in residential construction and many more in related work over this year's building season, an important stimulus to the construction industry and economy in general.

S.2226 clearly accomplishes its primary objectives - job creation coupled with financial assistance to potential home buyers.

There are, however, a few inherent problems in the bill that must be addressed.

S.2226 would authorize an interest rate "buy-down" of up to 4 percent, to result in a subsidized mortgage rate of not less than 11 percent. The mortgage rate would then be subsidized for a five-year period. This rate of subsidy is, in fact, insufficient, and would not permit most families to consider home ownership, even at an annual income of $30,000.00. For example, on a $65,000, thirty-year mortgage, the principal, interest and mortgage insurance premium payments would be $671.00 a month. Coupled with taxes, insurances and other expenses (based on FHA experience), the total monthly housing expenses would be $896.00, or $10,752.00 per year. This outlay equals 36 percent of a $30,000.00 income. In the sixth year, when the subsidy is removed, total monthly housing expenses could exceed $1,125.00 or $13,500.00 annually. This represents a significant percentage of a $30,000.00 annual income; for families at the median income level of less than $25,000, these expenses would preclude home ownership.

The length of the subsidy -- a five year period -- is another problem that must be addressed. S.2226 assumes that home owners will be able to pay a substantially greater amount for housing in the sixth year after purchase than in the first year. Given current economic conditions, this assumption is not necessarily valid. Home owners could encounter periods of unemployment or loss of income that could force them to default on the mortgage loan. This provision is similar to the "balloon payment" mortgage, currently offered for home finance, that has resulted in a record number of defaults and foreclosures.

It would be possible to have a program which did not place as much risk upon the home buyer by using the existing Section 235(q) program, with or without modification. Under Section 235, home owners do not have to increase their monthly payments unless a periodic examiniation shows an increase in income. Then the payments for principal, interest, taxes and insurance would be increased proportionately. This greatly reduces the risks of default and makes for a more sound government mortgage operation.

Our final concern is that the bill makes no provision for rental housing. As indicated earlier, a family earning $30,000.00 a year would be hard-pressed to meet its housing expenses. Families earning considerably less encounter greater difficulty in finding reasonable, affordable housing. These families must also be considered in the efforts to support the housing industry.

We believe that S.2226 can accomplish its objectives of aiding home buyers and the residential construction industry, if the above concerns are satisfactorily addressed.

One Liberty Plaza 165 Broadway New York New York 10080 212 637-7455

Merrill Lynch
White Weld
Capital Markets Group

April 6, 1982

The Honorable Richard G. Lugar
Chairman
Subcommittee On Housing and
Urban Affairs
5226 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

In connection with your hearings on S. 2226, legislation proposed by you to subsidize interest rates on mortgage loans for new homes, Merrill Lynch respectfully submits the following comments for the record.

Lugar Bill

S. 2226 provides for a 4% reduction in the interest rate or a reduction of the market rate to 11% whichever will cost the government less. The interest reduction will be provided on a Growing Equity Mortgage* (GEM). Under your bill a family's mortgage payment would increase by .75% of the mortgage amount each year. Over 5 years the amount the family pays increases while the Federal interest reduction decreases. The program seeks to protect the Federal government and could minimize costs in several ways:

- families are required to repay the interest reduction amount at sale;
- the use of a GEM reduces the interest cost to the Federal government; and
- the use of a GEM facilitates families being able to repay the subsidy.

Growing Equity Mortgages

GEMs were originally developed by Merrill Lynch in late 1981 and the name was trademarked. While our product is somewhat different from that proposed by you, the concept of an accelerated principal mortgage is the same. Let us explore why we think GEMS can be beneficial to the public.

---

* Trademarked by Merrill Lynch

The Current Market Environment

Recent economic conditions of high interest rates and low levels of housing activity have made the origination, sale and purchase of mortgages more difficult for lenders, underwriters and investors. Continuing high interest rates have also created a situation where normal financing techniques cannot fully serve the home buying public since many cannot qualify for most existing mortgage instruments under present economic conditions.

The Product

Accordingly, Merrill Lynch has developed a new mortgage instrument, the Growing Equity Mortgage in an attempt to address the problem of high interest rates, increase the number of persons who can qualify for financing, and increase the activity of the secondary mortgage market. How do GEMs work? The GEM concept is merely one of a variable payment, fixed-rate, accelerated principal mortgage. The GEMs we have developed so far begin amortizing as a traditional 30-year, level, monthly payment, fixed-rate mortgage. However, during the life of the mortgage, the monthly payment can be increased for the following year by a fixed escalation of 5 percent a year or increased or decreased according to an income-related index. This is not to say the accelerated principal concept could not be applied to other market interest rate indexes like those in FNMA's adjustable rate mortgage purchase program.

With a fixed interest rate, GEMs provide that the increased portion of the monthly payment is applied to principal. Thus, GEMs are amortized much more quickly than traditional mortgages, in approximately 12 years based on the previous 15½ year history rather than the traditional 30.

Specifically, the GEMs that we have developed have payments by the homebuyer that will: increase according to a fixed 5 percent increase a year; increase or decrease by a formula 75% of the increase in the Disposable Personal Income (DPI); or combine the two features to place a floor under the increases. DPI is short for "Per Capita Disposable Personal Income Index". It is calculated from the income received by all individuals in the economy by the U. S. Department of Commerce and is published monthly. The DPI, we believe, is a good index because it reflects the homebuyer's take-home pay increases, rather than store price increases. We use 75% of the DPI so as to provide a cushion against whatever increase occurs in consumer income vis-a-vis inflation.

Because of this safeguard and what we believe is a good concept, GEMs will be attractive to homebuyers whether the fixed 5 percent increase, the DPI index, or a combination of both are used. We recognize, of course, that while a fixed yearly increase can provide predictable payments for the borrower and a quantifiable rate of return for the investor, it can also cause problems in a deflationary environment. Therefore, it may be wise to explore other indexes combined with the accelerated principal concept.

Benefits to the Homebuyer

Homebuyers could benefit in several ways from the use of GEMs:

- Because of the probably much shorter average life of GEMs than on traditional 30-year mortgages, interest rates on GEMs should normally be lower than those of 30-year mortgages.

- Because of the accelerated amortization of GEMs, the total interest cost will be less than on traditional 30-year mortgages. As can be seen in the following chart, the interest savings on a $80,000 GEM at 14% will be as follows:

	Interest Cost
Traditional 30-year Loan	$263,432.00
Growing Equity Mortgage	89,236.00
Savings	$174,196.00

However, it must also be realized that the same is true if the mortgage term is shortened.

- Any increase in monthly payments are applied to principal, therefore, the homebuyer's equity in the residence will increase much more quickly than with a conventional mortgage. This is, in effect, a forced savings account.

- Unlike negative amortization instruments, the increasing equity base in the residence also will lead to a rapidly decreasing loan-to-value ratio. Because private mortgage insurance is generally required to be carried until the loan-to-value ratio reaches 80%, the homebuyer will also enjoy lower mortgage insurance expenses over the life of the GEM.

- The homebuyer's monthly payments will be limited to changes in the DPI, the fixed 5 percent increase, a combination of these two features, or other indexes.

Benefits to Originators

GEMs will also benefit originating lenders:

- Due to the lower mortgage interest rate realized as a result of the GEM structure and competitive pricing, a larger number of homebuyers will qualify for loans. This should produce more origination fees.

- In addition, underwriting and servicing will be far simpler with GEMs than for certain other alternative mortgage instruments. The originating lenders will be able to calculate easily the required amortization schedule for GEMs on an annual basis utilizing the simplest formula of a mortgage currently available.

- Because of the scheduled increases in payments GEMs may not only produce more cash but dependable, reinvestable cash if reliable indexes are chosen. This cash flow may be used to create additional fee income from new mortgage or other investments.

- GEMs, as with any indexed payment mortgage, will create a threshold or payment shock barrier where refinancing for a wholly new loan. This will produce fee income for the originator and additional cash flow for the investor.

- Our review finds that GEMs are legal investments for most mortgage companies. In addition, we expect the Federal Home Loan Bank Board (FHLBB) will issue regulations for comment in the next thirty days to authorize the making of our investment in GEMs by FSLIC-insured institutions. Similar approvals are being pursued with other regulatory bodies.

Benefits to Investors

- GEMs, we believe, will provide a greater cash flow during high interest rate periods and lower cash flows during opposite periods. The tax-free return of principal and the reinvestment of the cash flows in high interest rate periods will be beneficial.

- Investors will benefit from the shorter-loan life of GEMs of 12 years fixed payment (based on a 5 percent escalator) and an average life of 8.38 years. Therefore, investors can reinvest their funds much more quickly. The shorter asset maturity will help protect investors from inflation by generating sizeable cash flows in periods of high inflation. One should also consider that the purchase of this instrument is comparable to the purchase of a shorter term AA or AAA bond-like instrument with a 8-year bond average life rather than a traditional mortgage with a longer maturity, assuming a price convention of a 12-year average life.

- GEMs do not lend themselves to assumption because of the escalating nature of the payment. This means that GEMs are not as subject to the due-on-sale problem. The escalation of payments also makes wrapping GEMs uneconomical.

- GEMs are demonstrably better security than a negative amortization mortgage because they manifest faster decreases in loan-to-value ratios. In deflationary periods they enable homebuyers to avoid default more effectively. The loan-to-value ratio decreases to 80% about three times as quickly for a 95% GEM as for a 95% conventional 30-year mortgage loan.

- GEMs will give additional protection against prepayments in a falling mortgage market, especially if interest rate concessions to 30-year, fixed-rate mortgages are made on origination and initial sale.

- GEMs that utilize a fixed escalator and, therefore, more dependable cash flow will facilitate the hedging of the instruments with interest rate futures.

Conclusion

In conclusion, we applaud your efforts to utilize this newest innovation in mortgage finance to revitalize the homebuilding industry and provide more jobs.

If we can be of any further assistance, please do not hesitate to call on us for assistance. We appreciate the opportunity to make this submission for the record.

Very truly yours,

Gordon R. Watson
Managing Director
Government Guaranteed and
Mortgage-Backed Securities
Group
(212) 637-1643

McLEAN, VA., *April 29, 1982.*

Senator LUGAR,
Chairman, Subcommittee on Housing and Urban Affairs,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR LUGAR: I have been advised by members of your staff that the hearing record on S. 2226, recently reported out of your subcommittee, is still open. If possible, I would appreciate having the attached statement entered into the record along with testimony presented at the hearings.

I have observed the operations of this nation's many efforts to "help the housing industry" and to provide shelter for low and moderate income families over a period of some 12 years as a career policy official of the Department of Housing and Urban Development. For more than six years I headed the Office of Urban Policy Development and was intimately involved in the formulation and analysis of strategies for rebuilding America's cities. My duties brought me into constant contact with the serious policy and economic deficiencies that persisted through the Nixon-Ford-Carter years.

The bill you have reported out promises to perpetuate most of the serious mistakes of the past. It will help sustain high interest rates on mortgages, rather than bring them down. It will benefit the lenders more than it does the home buyer. And it will permit the building and realty industry to continue to "overbuild" housing in a price range still well out of reach of the mass market for home ownership. As I point out in my testimony, a direct front end subvention is the most efficient method of applying Federal assistance dollars, and will prevent diversion of resources into the pockets of people that are—in the main—already either very well off or rich.

I also urge that the Congress not go looking for new and additional revenue sources to fund such a program as is contemplated under S. 2226.

I especially urge that you take no actions under the guise of pump priming that will add to the size of the National Debt and the soaring cost of debt service.

There is a much better way of raising the funds required. Put a ceiling on the mortgage interest deductibility provisions of the Internal Revenue Code. In fiscal year 1983 that deduction provision, which is available to homeowners only, will cost the Treasury of the U.S. government over $25 billion. This is an enormous and unnecessary home purchase subsidy, mainly of benefit to high income families, which ought to be either turned off completely or else greatly reduced by limiting the mortgage interest deduction to a maximum of—say—$2,500 annually. Such a limit would automatically provide increased revenues 3 or 4 times the amount required to fund S. 2226, or some other "housing stimulus" bill. There will never be a better opportunity to move in on this unnecessary tax expenditure item.

Under my method of using the proposed $5 billion subsidy some 400,000 units (at $50,000 each) could be built and sold, with all of the government's subsidy dollars showing up as equity in the house itself. There would be no diversion into interest flows, hence no propping up of high interest rates. In other words, we should put the Federal subsidy into bricks and mortar and into skilled labor, rather than into paper, into unearned income, and into profit structures and fees. The enormous overhead costs of housing production under conventional market techniques has long been identified as the curse of the industry. Why not take this occasion, while the industry is in such agony and is so hungry for a Federal hand out, to teach the industry a better way of doing business—one that give home buyers a break, rather than just one more bonus for the bankers?

Sincerely,

HOWARD E. BALL.

TESTIMONY OF HOWARD E. BALL

My name is Howard Ball. I served for several years as Director of the Office of Urban Policy Development in the Department of Housing and Urban Development, retiring in May of 1979, after more than 36 years of Federal career service. I have had an unusual opportunity over the years to observe and to analyze the role of the Federal government as an intervenor in the supply of housing.

The current so-called housing crunch provides us with a rare opportunity to learn from past mistakes, and to seek less costly and more efficient ways of applying Federal subsidies to the stimulus of housing supply.

S. 2226 proposes to put some $5 billion into mortgage interest subsidies over a 5 year period, with reparment provisions attached upon resale. The primary justification is said to be job generation.

The main effect of this bill will be to prop up the already tragically high interest rates attached to mortgages. Hence this bill will deepen the housing crisis, rather than help relieve it. It will be rewarding lenders for doing nothing, encouraging builders to overdesign and overprice new construction, and will not produce any permanent benefits for home buyers and consumers.

Moreover the revenue demands of this proposal need not be met either by imposition of new taxes or by driving even higher the National Debt and the cost of debt service. A better and obvious funding source is standing in the wings waiting to be tapped.

How best should we use some $5 billion, if not by making below market interest rates available? The most efficient use of the Federal subsidy would be to apply the funds to a direct front-end equity and price write down. To be absurd for a moment, you could build and give away some 100,000 units, avoiding all borrowing and interest burdens—if that were sound public policy, which it is not. At the 50 percent subvention level, 200,000 units could be built and marketed, free from half of the crunching "paper" costs normally imposed on home buyers.

With a 25-percent write down, some 400,000 units (at $50,000 each) could be brought on stream, made available to low and moderate income families, affording them interest savings equal to or greater than could be realized under S. 2226. The amount of people benefits in the form of jobs, supplier sales, fees and commissions, insurance sales, etc., would be virtually the same. Competitive pressures on mortgage borrowing an on aggregate borrowing would be reduced significantly. There would be no direct propping up of already high interest rates, and Federal funds would wind up in permanent brick and mortar equity—actually on the site and in the structure—rather than in the profit and dividend structure of the banking and mortgage lending industry. The direct Federal investment would be deflationary. It could also be recoverable upon turnover or resale, with the mechanics being much more readily carried out (or with some specified portion of the subvention being preserved and handed on to a qualified second or third buyer).

The ready source of funds for such a program as I propose (or for S. 2226 as drafted) is in the capping of mortgage interest deductions under the Internal Revenue Code. A cap of $5,000 annually would yield over $30 billion dollars within the next five years. A cap of $10,000 would yield enough to fund S. 2226 as written. A cap of $2,500 would yield enough funds to more than pay for the highest level of HUD outlays ever experienced under its traditional housing programs, plus the Farmers Home Administration and the GNMA subsidies.

The effects of the existing tax expenditure are very bad for the housing market, encouraging misallocation of capital, over-investment in housing at the expense of other critical production factors, and sets up an income transfer process which largely nullifies the progressivity built into our Federal income tax for those fortunate families in the higher income brackets.

Now is the time to switch Federal intervention into those channels and for those families where it will accomplish the maximum social and economic benefit, while still providing jobs and economic stimulus to a lagging industry. This is no time to squander scarce dollars.

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